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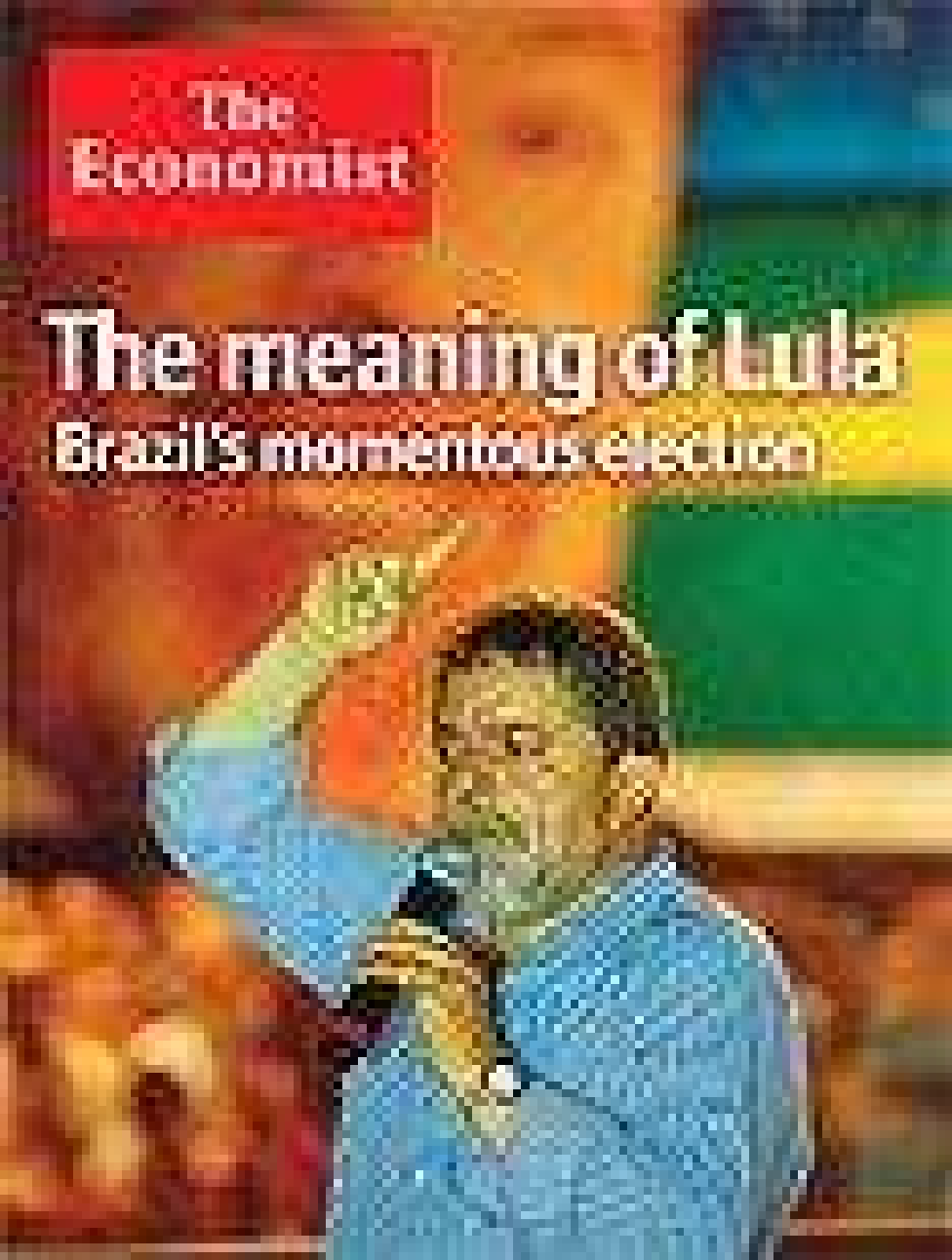
The meaning of Lula

Brazil's momentous election



PRINT EDITION

Full contents
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Past issues/regional covers
Subscribe

GLOBAL AGENDA
POLITICS THIS WEEK
BUSINESS THIS WEEK
OPINION
Leaders
Letters

WORLD
United States
The Americas
Asia
Middle East & Africa
Europe
Britain
Country Briefings
Cities Guide

SURVEYS

BUSINESS
Management Reading
Business Education
Executive Dialogue

FINANCE & ECONOMICS
Economics Focus
Economics A-Z

SCIENCE & TECHNOLOGY
Technology Quarterly

PEOPLE
Obituary

BOOKS & ARTS
Style Guide

MARKETS & DATA
Weekly Indicators
Currencies
Big Mac Index

DIVERSIONS

RESEARCH TOOLS

CLASSIFIEDS

DELIVERY OPTIONS
E-mail Newsletters
Mobile Edition
RSS Feeds

ONLINE FEATURES
Cities Guide Go
Country Briefings Go
Audio interviews Go
Classifieds Go

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Print Edition — October 5th 2002

The meaning of Lula
Good for Latin American democracy. How good for Brazil? ...
More on this week's lead article

The world this week

Politics this week
Business this week

Leaders

Brazil's presidential election
The meaning of Lula

The UN and Iraq
Pick the right fight

Farm policy
Scandalous

Investment banking
Wailing Wall Street

Japan
Moving on the banks

British exams
Who's been cheating?

Letters

On airlines, oil, Hong Kong, nerds

Special Report

Brazil's election
Can Lula finish the job?

United States

Dealing with Iraq
Open up everything, or else

The economy
Going down?

Maryland politics
Connie's conundrum

Black politics
Home truths from the Barbershop

Crossing the border
Just step this way

The attack on evolution
On the sixth day, post-modernism

Lexington
Mephistopheles and the Torch

The Americas

Health care in Canada
Theatre of discontent

Politics in Argentina
Delinquent

Mexico's film industry
The Mexicans are coming!

The Caribbean
Hung up on getting strung up

Asia

Pakistan's election
Khaki election

China
The case of the poisoned ducks

The Asian Games
The Koreas united, for a day

Uzbekistan
The European Bank for Repression and Dictatorship?

The Philippines

Previous print editions

Sep 28th 2002
Sep 21st 2002
Sep 14th 2002
Sep 7th 2002
Aug 31st 2002

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The market for chief executives
Bosses for sale

Celebrity ex-bosses
But not forgotten

American corporate profits
Damned if you do

Phone scams
You've got my number

Ford Motor
Rule Britannia

Business-to-business exchanges
Life after dotcom death

Chinese tourists
Follow the yellow umbrella

AIDS and South African business
Strategic caring

Face value
Le capitalisme sauvage

Finance & Economics

Investment banking under fire
Capitulate or die

Wall Street dining
George's is dead

Bank regulation
Too nice in Basel

Bank reform in Japan
The Takenaka challenge

IMF/World Bank meetings
Battling over the bankrupt

European insurers
Capital concerns

Banking secrecy
Squeezing the gnomes

Economics focus
Roots of development

Science & Technology

Light-emitting diodes
A solid future for lighting

The genomics of malaria
Two's company

Internet topology
What does the Internet look like?

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Daniel Ellsberg
The value of dissent

Historical biography
Lloyd George knew my father

Against Napoleon in Spain
Spanish lessons

American legends
A Confederate robber

Advertisement

It's war

The Philippines' presidency
Men and women in black

Middle East & Africa

Turkey and the Iraqi Kurds
Allies from hell

Iran and Europe
Friends in need

Côte d'Ivoire's civil war
The melting-pot cracks

Mozambique's ten years of peace
Booming, if a little bit dirty

Europe

Germany's government
A chancellor looks anxiously ahead

Spain and its Basques
Independence? Let's have a vote

The EU's agricultural policy
Reform? Forget it

French winegrowers
Unpalatable message

Italy's budget
Disappointing

Serbia's presidential election
Backwards or forwards?

Kosovo's final status
First, be nicer to each other

The International Criminal Court
Uncle Sam lays down the law

Norway's far north
What about rights for reindeer?

Charlemagne
Europe's Mexico option

Britain

The economy
Steady as she goes

Wind power
Crofters' Klondike

Sex industry
Stiff competition

More sex
Kiss, tell, cringe

Labour and the unions
A bloody nose

Secondary schools
Not very special

Census
Countless people

Bagehot
With friends like these

New American fiction
Bits and pieces

Russian composers
Modesty and melancholy

Proust in translation
Love by osmosis

Obituary

Kathleen McGrath

Economic and Financial Indicators

Overview

Output, demand and jobs

Prices and wages

Economic forecasts

Money and interest rates

The Economist commodity price index

Stockmarkets

Trade, exchange rates and budgets

Foreign-exchange reserves

Emerging-Market Indicators

Overview

Deaths from intentional injury

Economy

Financial markets

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Politics this week

Oct 3rd 2002
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Inspecting the possibilities

AP

Iraq said it would let UN inspectors return under rules set out by the Security Council in 1998. Not good enough, said America and Britain. They want a tougher new resolution including the automatic right to use force (rather than having another Security Council debate) if Iraq failed to make an honest accounting of its weapons of mass destruction.

See article: The UN and Iraq

In Washington the House of Representatives gave President George Bush the right to use **force against Iraq** as he thinks “necessary and appropriate”. The Democrat-led Senate was expected to agree, with some minor changes of wording.

See article: Coalition-building

The Democrats' control of the Senate wobbled when Senator Robert Torricelli abandoned his New Jersey seat after accusations of **illegally accepting money** and other gifts. Frank Lautenberg was picked to replace him in next month's election; but the Republicans pledged to fight the change as far as the Supreme Court.

See article: Robert Torricelli's lost soul

William Bratton, the effective head of New York's police force, was picked to take charge of the beleaguered force in Los Angeles.

Soft on crime?

The 15 EU governments abandoned their attempt at joint resistance to demands from the Bush administration that they should agree to hand over no American to the new **International Criminal Court**. Each country will be free to make, or not make, its own deal with the United States.

See article: The International Criminal Court

Germany's foreign minister, Joschka Fischer, talked of an early visit to Washington to restore ties damaged by Gerhard Schröder's strident pre-election pledges not to join in any attack on Iraq. Friendly noises came from the State Department's Colin Powell. However, a long-time Washington hawk, and now Pentagon adviser, Richard Perle, said the best remedy would be for Mr Schröder—who won his election last month—to resign.

See article: Germany's government

New forecasts for **Germany's** 2002 budget deficit, already seen as perilously near the EU's would-be limit of 3% of GDP, suggest it will be well beyond the limit. Ditto for 2003.

France's government, still maintaining its widely disbelieved forecast of 2.5% growth for 2003, made plain it would not yield to pressure from the European Commission for early action to bring down its near-the-limit budget deficit.

The premier of Spain's **Basque region** outlined ideas for independence to the regional parliament and a referendum once the region is at peace. The ETA gunmen who prevent that were unimpressed; Spain's prime minister, Jose Maria Aznar, called the ideas those of a “fanatic”.

See article: Spain and its Basques

Brazil goes left

Opinion polls showed Luiz Inacio Lula da Silva of the left-wing Workers' Party not far short of outright victory in Sunday's presidential election in **Brazil**. But they suggested he might face a run-off, perhaps against Jose Serra, the government candidate. Brazil's currency and bonds recovered somewhat as investors appeared resigned to a Lula-led government.

See article: The challenge facing Brazil's Lula

At the opening of a new parliamentary session, Jean Chrétien, **Canada's** prime minister, promised more money for health. Doctors and health-care workers are on strike in two Canadian provinces.

See article: Canada's strained health system

Cuba's communist government signed contracts worth $90m with American food companies at the largest trade fair involving the United States held on the island since a trade embargo was imposed in 1962.

Israel backs off

Under American pressure, the Israeli army pulled out of **Yasser Arafat's** largely destroyed compound in Ramallah, though did not go far. Palestinian leaders condemned an American spending bill, signed by George Bush, decreeing that no money could be spent on official documents mentioning Israel unless they also identified Jerusalem as its capital. An Amnesty International report found that over 250 Palestinian and 72 Israeli **children** had been killed in the conflict in the past 23 months.

See article: Israelis and Palestinians

Saudi Arabia's top security chief, General Taha Khosaifan, resigned after a German citizen, working for an electronics company in Riyadh, was killed by a car bomb. Two Britons have been killed in similar separate incidents over the past two years.

Morocco's general election results saw a turnout of just over 50% and the two big parties roughly equal. The PJD, the only recognised Islamist party, tripled its number of seats to 42 out of the 325 available. The king will appoint a prime minister to head a coalition government.

Abdoulaye Wade, **Senegal's** president, promised an investigation after a ferry disaster that claimed nearly 1,000 lives last week. The *Joola*, an army-operated ship licensed to carry 550 passengers, took on twice as many and overturned. Senegal's transport and army ministers both resigned.

Nigeria's president, Olusegun Obasanjo, promised that appeal courts would overturn all sentences of death by stoning passed on adulterers by Islamic courts in northern Nigeria. Given the separation of executive and judiciary, he probably has no authority to make such a promise.

A flight ban imposed by **Sudan's** government has cut off 500,000 people receiving supplies from UN aid-flights, the World Food Programme complained.

Sam Nujoma, **Namibia's** president, who is also information minister, ordered state television to stop showing western programmes. Given that Namibia (pop: 1.8m) produces few programmes of its own, broadcasters were unsure how to comply.

Unsafe election

At least 30 people died in election-related violence in Indian-ruled **Kashmir**, including five Indian border guards killed in a landmine explosion and two people killed in an attack on a bus carrying Hindu pilgrims. The four-round poll ends next week.

AP

Authorities in the western **Indian** state of Gujarat imposed a curfew after clashes between Hindus and Muslims in the city of Bhavnagar. Security had been tightened following an attack on a Hindu temple last week in which more than 30 people died.

Returning from a three-week visit to **China**, an envoy of the Dalai Lama said that contact had been re-established between the Tibetan religious leader and the Chinese government, signalling a thaw in relations.

An American envoy, James Kelly, visited **North Korea** to reopen diplomatic contacts after a freeze of almost two years.

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Business this week

Oct 3rd 2002
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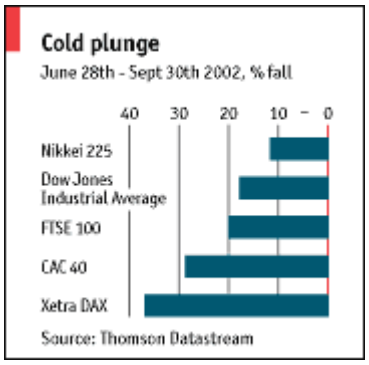
Rough and tumble

The **world's stockmarkets** suffered their worst quarter for 12 years. The Dow Jones Industrial Average fell by 17.9% and ended September at a four-year low, before bouncing on October 1st. European markets did even worse. Japan's market fell by just 11.7%, but to a fresh 19-year low.



America's bad bosses

Andrew Fastow, former chief financial officer of Enron, was charged with fraud, money laundering and conspiracy in connection with an accounting scandal that hid $1 billion of debt at the bankrupt energy-trading company.

See article: Out of work but still in the limelight

The contents of the Chicago head office of **Andersen**, the deceased firm responsible for Enron's audit, were auctioned. Among the bargains were 3,000 chairs, 5,000 workstations and a replica red London phone box—but not the famous shredding machines.

Eliot Spitzer, New York state's attorney-general, fired his latest **broadside against Wall Street**. He filed suit to recover profits of $28m made on share dealing by well-known executives—including WorldCom's Bernie Ebbers and Qwest's Joe Nacchio. Salomon Smith Barney, Citigroup's investment-bank arm, is accused of “spinning” the shares in much sought–after initial public offerings (IPOs) in return for business.

Goldman Sachs was also tarred with scandal. Congressional investigators say the firm allocated shares in hot IPOs to executives at 21 favoured clients including eBay, Enron, Global Crossing and Yahoo! Goldman noted that, unlike the practice at other firms, the executives had to ask for the shares rather than receiving them automatically.

See article: Investment banking under fire

Manhattan's prosecutors are investigating the part played by Tyco's auditors, **PricewaterhouseCoopers**, in the scandals enveloping the company. Interest centres on accounting techniques used to conceal millions of dollars in secret bonuses paid to top Tyco executives.

At a congressional hearing Gary Winnick, chairman of **Global Crossing**, a bankrupt American telecoms firm, offered $25m from his own pocket to workers who had suffered because their pension fund had a large holding of Global Crossing shares. He denied selling $100m-worth of company shares using insider information.

The cost of calling

Deutsche Telekom revealed plans to cut costs and deal with its burgeoning debt. It confirmed an announcement in May that it would axe some 30,000 jobs at T-Com, its fixed-line business—26% of the workforce—but extended the deadline by a year to 2005. It also said that 8,000 new hires would not go ahead.

France Telecom got a new chairman to replace Michel Bon. Thierry Breton, formerly chairman of Thomson Multimedia, took up the reins and now has the opportunity to try his hand at rectifying the state-controlled company's losses and cutting its mountainous debts.

See article: Thierry Breton, the new face of French capitalism

A key part of **Vivendi Universal's** debt-reduction plan went ahead after a last-minute hitch. The sale of Telepiu, an Italian pay-TV company, to News Corporation knocked some *euro*900m ($886m) off Vivendi's *euro*19 billion debt. But the sale of its publishing unit ran into trouble. Reports emerged of management collusion with a bidder; that, and the publishing arm's poor performance, could depress bids below a hoped-for *euro*4 billion.

Ericsson's shares plunged by 14% after the Swedish mobile-phone maker gave warning that sales and orders in the third quarter would be worse than in the second quarter.

The bleak outlook for semiconductors hit Britain's **ARM Holdings**. The chip maker's shares fell by 63% after it said that third-quarter sales would fall below expectations.

Reform at last?

Japan's slow progress towards shaking up its banks and dealing with their bad loans may be speeding up. Junichiro Koizumi, the prime minister, sacked the head of the Financial Services Agency and replaced him with a reformer, Heizo Takenaka.

See article: Japan's banking crisis

Credit Suisse's problems multiplied. It was forced to pump SFr2 billion ($1.35 billion) into Winterthur as plunging stockmarkets hit the value of its insurance arm's share portfolio. It handed over a similar sum earlier this year. Credit Suisse also said that falling markets would contribute to an operating loss in the third quarter at its investment bank, CSFB.

Six Continents, a British hotel and pub group, announced a demerger of its fancy international hotel chains from its rather downmarket British pubs and bars, a move long urged by investors. Shareholders will get a piece of both new companies and enjoy a special dividend of £700m ($1.1 billion).

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Brazil's presidential election

The meaning of Lula

Oct 3rd 2002
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Good for Latin American democracy. How good for Brazil?

AP

SINCE Brazil is the world's fourth-largest democracy, its presidential elections matter. But this Sunday's election carries unusual significance, and not just for 170m Brazilians. The vote comes as Brazil and much of South America teeter on the edge of another debt-induced financial disaster, with the potential to add a further large dollop of gloom to a sickly world economy. And the election's likeliest winner is not just another representative of Brazil's privileged elites. Rather, it is Luiz Inacio Lula da Silva, a former metalworker who heads Latin America's biggest left-wing party. The opinion polls are unclear as to whether he will win outright on Sunday, or face a run-off in three weeks' time. Either way, at the fourth attempt, Lula finally has the presidency in sight.

After two decades in which Brazil's restored democracy, like that of many of its neighbours, has been governed from the centre-right, a victory for Lula would seem to herald an unambiguous shift of direction. Following the Latin American debt crisis of 20 years ago, a wave of free-market reform swept the region, promising a new era of sustained growth and development. Since 1997, however, much of Latin America has been faltering economically. This appears to have pushed politics back towards the left and the statist nationalism of Latin America's previous half-century. Or so it may seem. But this perception is not necessarily correct. That is because a new Lula has emerged in this campaign. As the man himself likes to say: “I changed. Brazil changed”. So just what is the meaning of Lula, for Brazil and for Latin America?

A triumph of social mobility

The first thing to say is that victory for Mr da Silva would be a triumph for Brazilian democracy. In a region long ruled by generals or grandees, it would have been unthinkable not long ago. Lula's life story is a saga of social mobility worthy of a Brazilian television soap opera. The child of a dirt-poor family from the rural north-east, his formal education ended with primary school. He worked as a lathe operator in Sao Paulo, and then, as a trade unionist, led the strikes that did much to weaken Brazil's 1964-85 military dictatorship.

Lula's Workers' Party (PT) is also a by-product of the dictatorship. This is not a traditional Latin American leftist party, inspired by Moscow, Beijing or Havana. It is an alliance between trade unionists, community activists nurtured by Catholic “liberation theology”, and leftist academics. Rather than Marxist ideology, it has stood for radical democracy and social justice in a deeply unequal country. That makes it more pragmatic but also less easy to boss about from the centre. In sum, a Lula victory would do much to demolish the idea, more myth than fact, that Latin American democracy is still just a game rigged for the benefit of the better-off.

A Lula victory would do much to demolish the idea that Latin American democracy is still just a game rigged for the benefit of the better-off

Two things have made a Lula victory possible. One is that under Fernando Henrique Cardoso, president for the past eight years, Brazil has moved closer to becoming a stable modern democracy with some solid institutions. Mr Cardoso ended three decades of inflation, and did much to sort out chaotic public finances and establish an open, market-based, economy (see article). In these circumstances, voters are more prepared to take

risks. The other is that Lula has taken his party towards the centre—a process that has recently accelerated. This year, for the first time, he has appeared serious about trying to govern Brazil. He has sought and found moderate allies—a necessity given that his party will win less than a fifth of the seats in Congress. And he has scrapped earlier talk of defaulting on debts or reversing Mr Cardoso's privatisations. In August, he gave his blessing to a $30 billion IMF loan which commits the next government to maintain Mr Cardoso's strict fiscal and monetary policies.

Nevertheless, Lula leads the polls because he stands for change in a country that, despite Mr Cardoso's impressive reforms, is still riddled with corruption, violent crime, injustice and widespread poverty. At the local level, the PT has a generally clean record in government. Its more successful mayors and state governors have been practical reformers not rigid ideologues. Its arrival in the presidency would represent a healthy alternation of power.

The economic uncertainties

For all that, a Lula presidency will stand or fall on its management of the economy. One big worry is that the next government will have a difficult inheritance. Sadly, Mr Cardoso's reforms did not go far enough fast enough. A mere 18 months ago, Brazil looked set for sustainable growth. Then problems closed in. The world economic slowdown and the flight of investors prompted by Argentina's collapse have triggered a self-fulfilling financial panic. Brazil's currency has slumped and its interest rates have risen, threatening to render the public debt unmanageable. In contrast to the last debt crisis, most of the creditors this time are not foreign banks but Brazilian banks and pension funds. That means that some sort of voluntary debt restructuring might be possible, but also that much of the cost of any default would be borne at home.

A Lula presidency will stand or fall on its management of the economy

A second big worry concerns what policies Mr da Silva would implement if he were elected. His conversion to economic reality is too recent to be beyond doubt, and even if it is genuine inexperience could lead to mistakes. He is right to stress that Brazil's central economic challenge is to return to growth—a need to which the IMF agreement arguably pays insufficient attention. Since 1998, Brazil's economy has grown at a sickly annual average of 1¾%. Yet given the debt problem, it is hard to see any short-cuts. Lower interest rates are vital, but cannot come safely unless confidence improves. And since taxes already take close to 35% of GDP, there is little scope for increasing them to close the fiscal gap.

One radical path for Brazil would be to cut the entitlements of the better-off and concentrate state spending on the poor. That ought to appeal to a party of the left. Yet the PT opposed Mr Cardoso's efforts to do this, for example by cutting civil-service pensions. Lula's party draws many of its members from civil-service unions and public universities. He has done little to discourage the idea that he would throw money at social problems. And the industrialists and conservative political bosses now flocking to embrace him do so in the hope of state largesse. Abroad, Lula has until recently been happy to praise Fidel Castro's Cuba. But to succeed, he would have to establish a working relationship with the United States.

A successful government of the left could seal Brazil's still unsteady progress towards prosperity with democracy. That in turn would provide both an anchor and a model for South America. But if Lula does win, he would do well to recognise that success will come as much from continuity in policy as from change. Mr Cardoso's greatest achievement has been to make Brazil look governable. Maintaining that, without the luxury of piling up more debt, will not be easy.

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The UN and Iraq

Pick the right fight

Oct 3rd 2002
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Disarming Iraq is the issue, not getting inspectors back

Get article background

AP

IT IS worth giving Iraq one last chance to rid itself of weapons of mass destruction. Agreed? So isn't the next urgent step to get United Nations inspectors back into the country? Russia and France seem to think so; China seems ready to go along. But the answer is no. Perverse though it may seem to some, America was right to reject the return of United Nations inspectors to Iraq under a deal negotiated with Iraqi officials by the revamped special inspectorate this week. New rules will be needed before any new inspections take place. But the war-or-peace issue that ought to be gripping the Security Council is not the return of inspectors. It is Iraq's solemn duty to disarm. Council members, America sometimes included, all too easily lose sight of that.

The UN's own resolutions that ended the Gulf war are admirably clear on this point: it always was, and still is, Iraq's obligation to disclose its nuclear, chemical and biological weapons and then destroy them under international supervision; it is not the inspectors' duty to disarm it. This crucial distinction got lost, with disastrous consequences last time round, as Iraq cheated repeatedly on its obligation, the Security Council's attention wandered, and inspectors were forced to try and seek out and destroy what weapons they could. It risks being lost again in the diplomatic tussle over how to word any new UN resolution on Iraq and what new powers of search inspectors should be given.

When the Gulf war ended more than a decade ago, Iraq was given 15 days to come clean about what illicit weapons it held, and told it must then destroy them under the supervision of UN inspectors. By any measure, it has been a long 15 days, and Iraq has still not complied. Now that the Security Council is taking up the case again, Iraq should be held hard to that disarmament obligation. The question is how.

Aren't inspections the only way to do that, short of war? Quite possibly. But whether it makes sense for inspectors to return to Iraq at all depends on what Iraq does next. Its repeated insistence that it no longer has any weapons of mass destruction does not even pass the laugh test—and puts it in clear breach of its disarmament obligation. How does anyone know that? The old UN inspectorate could have papered UN headquarters with the succession of “full, final and complete” declarations that Iraqi officials presented to them over the years, only for it to be proved that each successive document was a tissue of lies. Those, like Russia, who want inspectors back now chiefly as a way of forestalling any military action will point to the thousands of weapons and tonnes of materials and equipment the inspectors did manage to destroy before they were thrown out in 1998. Those who want to see Iraq disarmed would do better to focus on the thousands more weapons and tonnes of materials the inspectors were just as certain they had been forced to leave behind.

Iraq's repeated insistence that it no longer has any weapons of mass destruction does not even pass the laugh test—and puts it in clear breach of its disarmament obligation

The lesson to be drawn is that disarmament by inspection can be achieved, as the Security Council's own resolutions foresaw, only with the full co-operation of the Iraqi government. If Iraq is now ready to co-operate, and hand over the weapons it has long been concealing, then inspectors have a key role to play in reassuring the world this is done effectively and honestly. For this they would need a new Security Council resolution that among other things reaffirmed their right to go anywhere (since the council had previously and mistakenly agreed that “presidential sites” would require prior notice), see anything, and talk to anyone.

And if Iraq persists in its denials? Returning the inspectors would be pointless. Giving them armed assistance—an idea floated by those who want tougher inspections as a better alternative to war—might indeed help them extract themselves from a dangerous stand-off, should Iraq seem to co-operate but then dig its heels in. But using troops to kick down doors would merely be to acknowledge that Iraq was already back in flagrant breach of its disarmament commitments, and that inspections were once again being fatally undermined.

Where there's a will, there's a way

Inspections cannot be a substitute for the Security Council's rediscovering the will to force Iraq to give up its illegal weapons. So far Russia and France have been all too ready to explore any option but war, reinforcing the impression Mr Hussein gained from his defeat of inspections last time: that, come a crunch, the council will do little more than wring its hands. America and Britain, for their part, stand accused of looking for any pretext to go to war in order to oust Mr Hussein from power. In truth, maintaining the distinction between disarmament and regime change (America barely tries) is virtually impossible while Mr Hussein insists on holding on to his weapons as well as his power. So is the regime-change lobby right: the only way to force Iraq to rid itself of its weapons of mass destruction is to get rid of the regime that builds them?

There is only one way of both disarming Iraq and proving the regime-changers wrong. That is for the Security Council to tell Mr Hussein unmistakably that he will be stripped of his weapons, by force if need be. The choice is then his.

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Farm policy

Scandalous

Oct 3rd 2002
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Europe's common agricultural policy should be scrapped, not defended

Alamy

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THIS summer the European Commission floated proposals for reform of the European Union's demented common agricultural policy. In many ways it was a timid plan, given all that is wrong with the CAP. The proposed reform aimed mainly to rearrange, not reduce, the mighty sums that the EU requires its taxpayers to hand over to farmers. The plan was nonetheless welcome. It would have broken the link between subsidy and production, tying farm aid more closely to rural conservation and—most important—reducing the extent to which the CAP dumps farm goods outside the EU, which drives down world prices at great cost to poor-country farmers.

How has this modest but welcome plan fared? Apparently, it was no sooner floated than sunk. Opponents of CAP reform, led by France, seem to have gathered the support they need, notably from Germany, to put the idea off until 2006, and maybe kill it altogether (see article).

Adding insult to injury, Hervé Gaymard, the French agriculture minister, and his counterparts from Luxembourg, Spain, Portugal, Austria, Ireland and the Walloon part of Belgium have just published what purports to be a defence of the CAP in the *Financial Times* and other European newspapers. “It is widely asserted that the CAP costs Europe too much,” they say, deeply puzzled. How could anybody regard *euro*40 billion ($39 billion) a year of direct subsidy (plus twice as much again in higher prices demanded of European consumers) as too much to pay for producing food nobody wants, keeping third-world farmers poor and wrecking Europe's rural environment? Cheap at the price, say the ministers.

Anyway, the CAP's defenders continue, the broader effects of the policy have been misunderstood: “Some also claim that the CAP is responsible for causing hunger in developing countries. Nothing could be further from the truth.” How so? Well, the third world should really stick to subsistence farming, the ministers explain: all this haste to develop cash crops, move into export markets and rise out of poverty is not at all suitable for poor countries. By inhibiting their efforts at agricultural development, you see, the CAP lessens that dangerous temptation. In truth the CAP helps poor countries. And what thanks for this does Europe ever get?

If these men—who cares whether they are fools or knaves?—prevail, the implications will be even worse than you might suppose. The Doha round of negotiations on world trade liberalisation hinges on progress in farm-trade reform. Many developing countries believe, with reason, that they were short-changed in the Uruguay round: this time, as a result, the outlook for progress is bad unless the rich countries liberalise agriculture, where the developing countries know they have so much to gain. Europe, of course, is not the only rich-world offender: American farm support, though smaller, also does great harm to developing-country farming and living standards, and the recent farm bill has added further to the burden. Europe might have used genuine CAP reform to encourage America to reduce its own farm subsidies—as America's trade officials now insist they want to. Again, none of this will happen if the CAP's defenders get their way.

Optimists may say that CAP reform is not dead, merely delayed. Again. But right now is Europe's best chance to sort out its farm-policy mess before enlargementadmits new farm-heavy countries whose governments will have an even bigger political stake in defending the status quo. The setback on CAP

reform is a scandal. And Mr Gaymard and his fellow farm ministers are a disgrace.

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Investment banking

Wailing Wall Street

Oct 3rd 2002
From The Economist print edition

Conflicts of interest cannot be regulated away in banks any more than in newspapers

THE third quarter of the year was grim for equity investors, with price falls of a fifth or more in most stockmarkets. It is now a racing certainty that this year will see a third consecutive decline in American share prices, the worst run since the depression of the 1930s.

The chief culprits are the bursting of the biggest-ever stockmarket bubble and well-justified gloom over world economic prospects. But burnt investors, eager prosecutors and aggressive regulators are not willing to leave things at that. They want somebody to blame, and have lit on the infectious greed that characterised Wall Street's investment bankers in the bubble years. They are seeking not just punishment for wrongdoers but wholesale reforms of the industry's structure.

The charge is being led, incongruously enough, not by federal regulators but by a bevy of state attorneys-general, headed by New York's Eliot Spitzer. In May Mr Spitzer secured $100m plus structural remedies from Merrill Lynch over the behaviour of its research analysts. He has since gone after Citigroup for “spinning” hot initial public offerings to clients in exchange for investment-banking business, a practice he sees as bribery. Other banks are being carved up among his fellows: Utah gets Goldman Sachs, Texas J.P. Morgan Chase and Alabama Lehman, for instance (see article). All hope to emulate Mr Spitzer by reaping windfalls for state coffers. Mr Spitzer, meanwhile, has even suggested that remedies for Wall Street's malfeasance might vary from bank to bank.

This way madness lies. It is welcome that the federal Securities and Exchange Commission (SEC) is, belatedly, seeking to bring some order to the mess. It wants a simultaneous, industry-wide solution that puts a stop to further investigations, with any fines paid into a compensation fund. It may find it hard to pull publicity-hungry state prosecutors into line. But the real argument now should be over what if any structural changes are needed. In particular, prompted by Mr Spitzer, the SEC is considering whether to impose a separation of research analysis from the rest of investment banking.

Living and dying by the market

On the face of it, this seems an attractive idea. If analysts' buy and sell recommendations are coloured by their prospects of winning advisory work from the companies concerned, they do a disservice to their more gullible investing clients. The behaviour (and pay) of such erstwhile masters of the universe as Citi's Jack Grubman, who said conflicts of interest were really synergies, and Merrill's Henry Blodget, who referred to stocks he touted as “crap”, was both shocking and distasteful. Investors might be better served by genuinely independent research, even if they have to pay for it.

That may well be the direction in which the market evolves, although even big investing institutions seem reluctant to spend much on research (a comment, perhaps, on how valuable such research is). Yet it would be wrong for regulators or legislators to enforce this outcome. Conflicts of interest are inherent in many industries. Only rarely should they lead to laws: for a statutory investor-protection function such as auditing, a ban on consulting work for audit clients is right. When what is in question is a market not a statutory activity, the best response is to ensure that customers know that conflicts exist, and rely on market forces to resolve them.

Consider a close-to-home analogy: newspapers, which earn their crust by taking paid advertisements from companies even though they may write about them. To safeguard their reputation, respectable media ensure that advertising and editorial staff are kept strictly apart. Yet Mr Spitzer might argue that this affords readers insufficient protection. Instead, newspapers could be banned from accepting advertisements, and made to charge the full price for their product. But that would hardly benefit the public, for the likely result would be less choice at higher cost, with an added incentive for companies, denied the chance to advertise openly, to seek hidden and more insidious ways of buying coverage.

New rules follow every financial crash, almost always with unintended consequences. The 1930s produced Glass-Steagall, which banned commercial banks from supposedly riskier investment banking. By the time it was repealed, banks had found not only how to get round it, but also how to lose on dud loans oodles more than any investment bank ever has. The latest crash has already cleaned up most of Wall Street's excesses—that is how markets work. More disclosure would be desirable; more rules would not be.

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Japan

Moving on the banks

Oct 3rd 2002
From The Economist print edition

The chances of a resolution to Japan's bad debts have improved. No, really

AP

HISTORY may judge this to be the week when the Japanese government resolved to cut out the rot at Japan's banks and so took the first step to restore the economy to a semblance of health—and only a little more than a decade after the problem first cried out for a remedy. In his first 18 months as prime minister, Junichiro Koizumi dithered over the banks, whose bad loans are officially reckoned to be ¥43 trillion ($345 billion), equivalent to 8% of GDP, though more realistic estimates put them at twice or even three times that figure. But on September 30th, he declared that “we cannot tackle economic revitalisation separately from financial issues.” And instead of the minor cabinet reshuffle that his office had signalled, Mr Koizumi sacked the country's top financial regulator, Hakuo Yanagisawa, head of the Financial Services Agency (FSA).

By repeatedly denying that there was anything wrong at the banks that time could not cure, Mr Yanagisawa had himself become one of the biggest obstacles to reform. His replacement, Heizo Takenaka, who continues also as economics minister, is young, reformist and acutely aware of the banks' true condition. Banks' share prices fell after Mr Koizumi's reshuffle. With luck, this signals that real action—in particular, accelerated write-offs of banks' bad loans—will mean real pain.

Certainly, the prime minister is now staking his political capital on such action. Mr Takenaka swiftly announced a task-force for cleaning up the bad-loan mess, and it includes another committed reformer, Takeshi Kimura; it is to report later this month (see article). However, proposals that put companies out of business or close down banks are likely to run up against the near-immovable mass of the ruling Liberal Democratic Party (LDP). The LDP complains that Mr Koizumi's new resolve is prompted more by pressure from outsiders—especially the IMF and the Americans—than by domestic imperatives. LDP politicians note with relish that Mr Takenaka, an academic, is no political heavyweight.

All the same, Mr Koizumi has some momentum. The extraordinary announcement two weeks ago by Masaru Hayami, governor of the Bank of Japan, that the central bank would buy banks' equity holdings, so concerned was it about the health of the banking system, put the focus on the FSA's inaction. The finance minister, Masajuro Shiokawa, seemed to support Mr Hayami when he said in Washington, DC, that bank consolidation and an injection of public funds were perhaps not such bad ideas. That appalled his ministry, always at war with the Bank of Japan.

There are two broad ways to deal with the banks' bad loans. The first, less satisfactory approach is to prop up the banking system by using public funds to buy loans from banks for more than they are worth. The government would then—swiftly, with luck—dispose of the loans by selling some at a discount and writing others off. The managers who got banks into the mess would remain, with taxpayers paying the bill. The risks of moral hazard would abound; but at least banks would be free to lend again.

The second, crunchier approach is to lay down tight rules for evaluating loans, and insist on realistic provisioning for them. That would entail the bankruptcy of many borrowers, particularly in construction and retailing, and big losses at banks. Some would go bust, and many more would need injections of public capital. Some banks would have to be nationalised and their managers kicked out. Once returned to health, they could be privatised again. Encouragingly, Mr Takenaka favours this more radical approach.

Without careful government co-ordination, though, any such action could be positively dangerous. If widespread bankruptcies tipped millions out of work, that would exacerbate the deflation that has, since the mid-1990s, done so much to compound the banks' problems. The same deflation, if left untended, will guarantee that, even if banks became able to lend again, asset markets would still not function: nobody wants to borrow when deflation depresses revenues and increases the real debt burden year after year.

That is why reflation by the Bank of Japan is needed more urgently than ever. Yet Mr Hayami appears to be the only central banker who seems to deny authority over monetary policy. Getting Mr Yanagisawa's head might just have confirmed his belief that the roots of deflation lie anywhere but in monetary policy. The best measure now of the prospects for clearing up the mess in the banking system would be evidence of genuine reflation (notably through buying in government bonds) by the Bank of Japan.

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British exams

Who's been cheating?

Oct 3rd 2002
From The Economist print edition

Exams are about sorting the bright from the dim, not about demonstrating progress

Get article background

"IN THE first place," observed Mark Twain, "God made idiots. This was for practice. Then he made school boards." The recent conduct of England's exam boards, as well as that of the politicians and regulators who share responsibility with the examiners for determining the future of the nation's pupils, tends to support his view.

For years, the proportion of 18-year-olds getting high grades at A-level has been rising. This is probably because of a combination of factors. Fifteen years ago, the government switched from a relative to an absolute system of marking, so that, as teaching improved—and teachers do seem to have got better at preparing pupils for exams—the proportion of high marks would rise. That fits in with the current government's plan for more youngsters to get A-levels, so that more can go to university. At the same time, critics say, exams have got easier.

Concern about the devaluation of grades lies behind the current crisis, which arose over the introduction of a new A-level system. Examiners realised that the exams were too easy, but could not agree about how to keep standards consistent with the old A-levels. Instead of explicitly holding steady the proportion of students that got top, middling and low grades, they seem to have panicked and marked some papers brutally lower to depress averages.

When the news broke that the nation's children had been cheated, there were cries for heads on pikes. Estelle Morris, the education secretary, duly sacked Sir William Stubbs, head of the Qualifications and Curriculum Authority, the government's exams watchdog, and ordered an inquiry—which has recommended that 300,000 papers in 26 subjects should be reviewed. Some of the victims of this mess, meanwhile, have not been able to take up university places, because they are still waiting for their real grades. Many may sue.

It seems clear from all this that the combination of private exam boards, public regulation and political interference is not working. What's the solution? Chris Woodhead, a critic of Labour's education policy and former chief inspector of schools, reckons that the government should leave exams to the market. Bring on more exam boards, he says. Let the different boards offer different qualifications with different values. Just look at university degrees. Everybody knows that the value of your degree depends largely on which university you got it from. Why shouldn't that be true of the exam boards which set and mark A-levels too?

The market doesn't work

In most cases where public and private roles have become entangled, the best solution is indeed for the government to step back and leave things to the private sector. Not in this case. Competition between the three existing exam boards has not improved the service they offer English schoolchildren. On the contrary, it has encouraged grade inflation, as the boards jostle to provide the results that will make their customers happy. More exam boards would compound that problem. Mr Woodhead's comparison with university degrees does not help his case. Nobody really knows what different degrees from different universities are worth. Exams should produce qualifications whose value is easily understood.

Mr Woodhead argues that if exams are set or regulated by a government-funded body, political interference is inevitable. That is not necessarily so. The Bank of England, whose job is to maintain the value of a different sort of currency, has been doing rather well since it became fully independent in 1997. The QCA could have similar constitutional independence. At the same time, the government should order it to return to the old, relative, system of marking, and give the QCA a rule, similar to the Bank's inflation target, for the proportion of pupils to achieve As, Us and everything in between.

Exams are not there to record how the nation's children are improving over the years. They are there to separate the bright from the dim. It's a dull job, but an important one. If governments cannot be trusted to maintain the value of a currency, people begin to wonder if they can be trusted at all.

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Letters

Oct 3rd 2002
From The Economist print edition

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Flying into trouble

SIR – The problems facing airlines are not new but reflect inherent features of the industry which make it impossible to earn a viable long-run rate of return ("So many planes, so few passengers", September 21st). Low-cost carriers are only part of the problem.

Traditional hub-based airlines provide the foundation of the system. The hub structure has the economic advantage that a diverse range of cities can be served efficiently. By consolidating traffic through a hub, the system allows many smaller communities to have access to the air-transport network. Point-to-point services do not do this. The difficulty is that scheduled airlines, competing with each other through hubs, inevitably try to fill aircraft at the expense of rivals. They will take any passenger that covers the immediate costs of the seat. The pressure is to cover short-term costs; any contribution to capital costs becomes a bonus. Hence the 2.9% net margin you cite.

Regulators have tended to ignore this sort of issue and it may well be generic to a number of network-based industries with committed costs. While competition has demonstrable benefits, it must occur within an appropriate institutional framework.

Kenneth Button
George Mason University
Fairfax, Virginia

SIR – You assume that European and American liberalisation is sufficient for a curative "open skies" agreement. While structural issues such as regulation, sovereign finance, antitrust or citizenship restrictions on investment have various effects on the airline industry's finances, neither the private nor public sector has advanced a comprehensive analytically-based framework to optimise industry economics.

The current state is a jumbled mix of archaic, incomplete or conflicting rules and objectives. For example, American deregulation in 1978 has fostered some successful low-cost competition to the benefit of consumers while antitrust laws remain entirely dormant in restraining incumbent carriers from wasteful anticompetitive behaviour against this competition. In the meantime, the incumbent carriers look to the federal government (ie, taxpayers) for bail-outs. The government still confusedly sustains the notion that big airlines are in effect sovereign assets demanding de facto federal control.

The European, Asian and Latin markets have created business models that better serve consumers and investors but like American counterparts succeed by allowing smaller-scale operations that arbitrage the cost distortions of the larger "sovereign" carriers. While open skies would undoubtedly help to clear transatlantic excess capacity and liberalisation between America and Europe would help to guide the logic of the marketplace worldwide, it must be preceded by better internal-market regulation. These markets are far from coherently liberalised.

Matthew Andersson
Scottsdale, Arizona

Fuelling America

SIR – You say that America's dependence on oil imports from Saudi Arabia forces it to obtain supplies from “uneconomic” sources (“Don't mention the O-word”, September 14th). If America is willing to pay a premium for oil from stable countries it may be well advised to continue to do so. Saudi Arabia is America's largest foreign supplier of crude oil at 588m barrels in 2001, but Mexico is second at 509m barrels and Canada third at 495m barrels. Including natural gas, Canada is the largest source of American fuel imports.

Marc Schindler
Spruce Grove, Canada

SIR – Let's mention the “O- word”, loud and clear. Canada has about 2.5 trillion proven barrels of heavy oil in place. If only 30% of this is recoverable by present and future technologies, it is enough to meet current aggregate consumption for America and Canada for the next 100 years. Venezuela has similar amounts. The Bush administration is well aware of this. Perhaps the pressure on Iraq is purely for the purposes of peace and democratisation. Perhaps Europeans should be less cynical but they are the ones with a looming oil-supply problem for which America has a nearby solution.

Maurice Dusseault
University of Waterloo
Waterloo, Canada

SIR – The probable aftermath of a collapse in oil prices, particularly if it involves the collapse of OPEC, could be the end of the oil-production industry in the rest of the world. The loss of the stabilising influence of the OPEC cartel could bring down the price of oil to a level where only production in the Middle East could compete. Does anybody want this?

Ash Farhang
Greenwood Village, Colorado

Hong Kong's law

SIR – I take issue with the disparaging remarks you make concerning the motives of the Hong Kong government and its lawyers. Your criticisms of Hong Kong's proposals for laws covering offences against the state are not warranted (“Subverting autocracy” and “Death by slow boiling”, September 28th).

You correctly report that the proposed offences of treason, secession, sedition and subversion all require the commission of or the incitement to commit acts of violence against people, property or services. It is simply inaccurate to say that under the proposals an organisation banned on the mainland could be banned “automatically” by Hong Kong if China decides it is a threat to national security. The power of proscribing organisations in Hong Kong could only be exercised if the secretary for security reasonably believed, in conformity with the standards of the international covenant on civil and political rights, that it was necessary in the interests of national security, public safety or public order to ban that organisation. Moreover, the secretary for security's decision would be subject to appeal and review in the courts. Nor is there any reason to fear that the proposals could be used to suppress journalistic or academic research. Even you grudgingly recognise that we have worked hard to ensure that the proposals complied strictly with international covenants protecting rights and freedoms.

James O'Neil
Solicitor-general (acting)
Department of Justice
Hong Kong

Editor's note: According to the Hong Kong government's draft proposals however, "to a large extent, on the question of whether such a mainland organisation endangers national security, we should defer to the decision of the Central Authorities based on the comprehensive information that it possesses" (paragraph 7.16).

Nerds do well

SIR – Your article on Sun's N1 operating system is clearly the work of someone who feels threatened by “nerds” (“Delete the workers”, September 21st). You make it painfully obvious that you have some

serious axes to grind with IT staff. Most technology consultants and systems administrators are well-rounded, educated and intelligent individuals, not a pack of misfits. The likes of my colleagues and I bear the brunt of every big company's technological operations. This is why we are often paid far more than our “superiors”, in addition to being more dashingly handsome and better dressed.

John Salomon
Zurich

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Brazil's election

Can Lula finish the job?

Oct 3rd 2002 | RECIFE AND SAO PAULO
From The Economist print edition

Reuters

Brazil has improved in many ways under President Fernando Henrique Cardoso. Yet Brazilians seem about to elect "Lula", his veteran left-wing opponent

RECIFE, a north-eastern Brazilian city famous for its vivid *Carnaval* parades, has a district called "Planet of the Apes". The history of this place shows how the lives of Brazil's poor have improved since the country returned to democracy in 1985, and especially since the election in 1994 of President Fernando Henrique Cardoso.

Planet of the Apes started out as a *favela* (shanty-town) of wooden shacks in the mid-1970s, after migrants from the dirt-poor backlands of Pernambuco state camped out beside a freeway on the outskirts of Recife, its capital. By local tradition, the *favela* was named after a television show of the time. In the late 1980s the residents were granted ownership of the land under their shacks, and began replacing them with simple brick-and-tile houses. In the late 1990s the homes were connected to a main sewer, and a nursery opened. Though it has kept its wacky name, its residents now proudly say that Planet of the Apes is a *bairro* (neighbourhood), not a *favela*.

Madalena da Silva, a short, stocky grandmother in her 50s who has lived there since the beginning, remembers how hard it was to cope with the roaring inflation that was ended by the *real* plan which Mr Cardoso, then finance minister, launched in 1994. Every pay day she had to dash to the shops to buy groceries before the prices went up. She never had money left over for the things she has in her home now: a television, a video and even a computer. Before Mr Cardoso privatised the inefficient state telecoms firm in 1998, telephone lines were so scarce that people would pay thousands of dollars for them. Now they are within the reach of poor Brazilians like Mrs da Silva. She received only primary schooling, but the expansion of the education system has meant that her two daughters went to university.

Mrs da Silva shares a surname and similar, humble, north-eastern origins with Luiz Inacio Lula da Silva, Brazil's veteran left-wing opposition leader and presidential candidate (for the fourth time) of the left-wing Workers' Party (PT). However, unlike many Brazilians, she will not vote for Lula in Sunday's election but for Jose Serra, the candidate of Mr Cardoso's centre-right coalition. "Fernando Henrique was a good president for the poor. It is the middle classes who are in revolt," is her theory on why Mr da Silva is so far ahead of Mr Cardoso's candidate.

The polls, however, are sending mixed signals. Mr da Silva enjoys a big lead among all income groups, with a smaller lead only among the poor (though of course one might expect the opposite from a left-wing candidate). But Mr Cardoso himself (who cannot stand again) remains quite popular, despite Brazil's recent weak economic growth and its current financial crisis. Only a third of Brazilians think he is doing a bad job, and a quarter rate him good or excellent. The polls show that parties from Mr Cardoso's coalition are expected once again to capture more state governorships than the PT or other leftish groups, as well as more seats in Congress.

Voters seem to be hedging their bets, reckons Marcelo Medeiros, a politics professor at one of Recife's universities. Pernambucans are set to choose Lula for president while re-electing Jarbas Vasconcelos, one of Mr Cardoso's closest allies, as state governor, whose powers over everything from housing to policing have at least as much effect on their lives. Furthermore, it seems less of a risk to bet on Lula for president after his move to the centre in the current election. Voters may be hoping that the new-look Mr da Silva, who has swapped his jeans for a business suit but has kept his beard and continues to promise big social improvements, will maintain the best of Mr Cardoso's policies while improving on his weak points.

Cardoso's score-card

Although Mr da Silva and his aides rail against Mr Cardoso's “neoliberal” policies and their supposed failure to alleviate poverty, the outgoing president has taxed and spent as never before, while poverty has fallen and other social indicators have improved. His most memorable achievement, one that several of his predecessors had attempted without success, was the conquest of **inflation**. When the *real* plan was launched, inflation was running at an annual rate of 10,445%. Soon afterwards, it fell to single figures and stayed there. Since the poorest had found it hardest to keep up with rising prices, this caused a drop in deprivation. A study last year by IPEA, a research body, reckoned that the proportion of Brazilians living in extreme poverty (defined as not having enough income to eat properly, let alone afford anything else) fell from 20% to 15% between 1993 and 1995, though it has not improved further since.

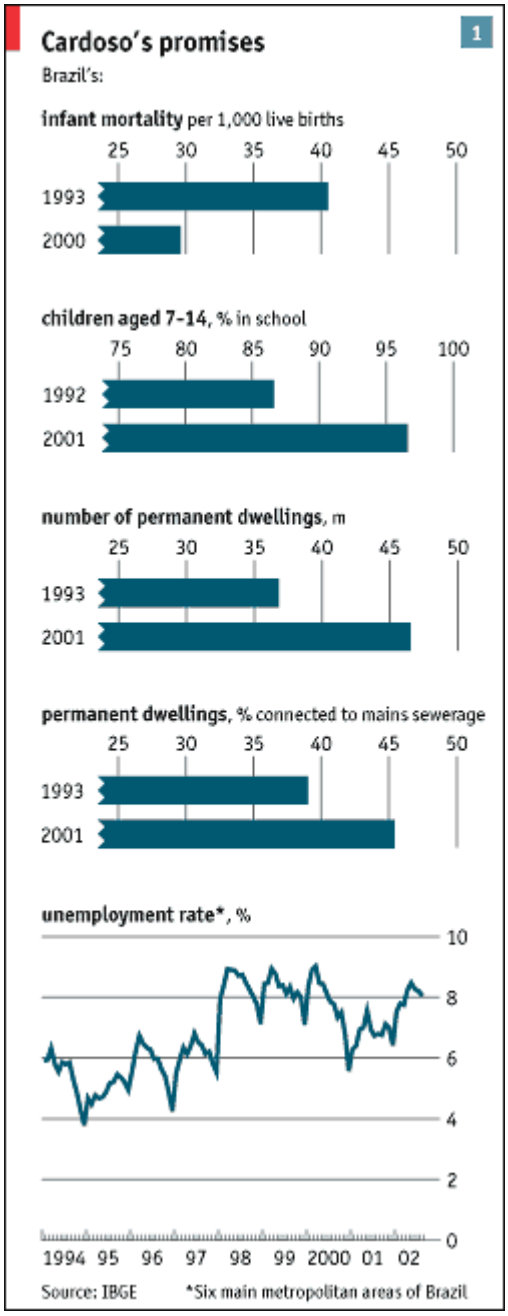
With his anti-inflation policy working well, in the 1994 presidential campaign Mr Cardoso made a number of promises to improve different aspects of Brazil. These varied according to where he was (crime in the cities, agriculture in the countryside), and often involved services delivered by state and city governments, rather than federal government. But broadly speaking, as the charts show, Mr Cardoso can claim to have kept many of his pledges.

EPA

The first was **health**. Infant mortality—the most widely used yardstick—has fallen significantly in response to various federal programmes, although Brazil remains behind some other comparable countries. A bold anti-AIDS programme (official exhortations to use condoms, cheap drugs for those with HIV) seems to have paid off: the number of new cases peaked in 1998 and is now below its 1994 level. Progress against other infectious diseases has been more variable: cases of dengue fever, for example, have increased.

In **education**, one of the areas in which Brazil has long been backward,

progress has been made. For the first time in history, almost all Brazilian children are going to primary school. Enrolments have soared in secondary and higher education, to the benefit of young Brazilians like Mrs da Silva's daughters. Among many new reforms was the *bolsa escola*, a benefit—pioneered by local PT governments—paid to poor families on condition they send their children to school. Yet, for all this, the rich world has been improving its educational performance faster, leaving Brazil still further towards the back of the class.



Mr Cardoso did not do anything radical about his promise to improve **housing**. Some big, wasteful federal construction programmes, used by governments to buy off congressmen, were scaled back, and more loans were made to individual house-buyers. Overall, though, the number of homes in Brazil has been rising faster than the population, and many *favelas* like Planet of the Apes have become proper neighbourhoods, though millions are still poorly housed.

One of Brazil's most enduring social problems has been the sometimes violent conflict between landless peasants and the *latifundiarios*, owners of huge and often under-used tracts. Mr Cardoso's **land reform** involved buying such land and helping peasants set up co-operative farms on it. More than 600,000 families have been settled during his mandate, three times as many as in the preceding 30 years—though Mr da Silva and the PT continue to portray themselves as the landless peasants' champions.

Mr Cardoso's promise to increase investment in **infrastructure** has been undermined by lack of money. Nonetheless, the proportion of homes with mains water and sewerage has grown by around six percentage points. And, propelled by privatisation, the share of households with a telephone has risen from 20% to 58% in the eight years to 2001. One in eight Brazilian homes now possesses a computer, and broadband Internet access for households took off faster in Sao Paulo than it did in London.

On **employment**, things do not look so good. The low growth that Brazil has experienced since 1998 (the year Mr Cardoso was re-elected) has meant that creation of new jobs has not kept up with the 1.5m or so young Brazilians who join the labour market each year. The official unemployment rate now stands at 8%, up from 6% eight years ago. Broader, unofficial measures that include underemployment are higher still. Mr Cardoso hoped to reform Brazil's archaic labour laws, which discourage employers from taking on staff. But the most important reform, to allow bosses and workers the freedom to negotiate contracts, remains stuck in Congress.

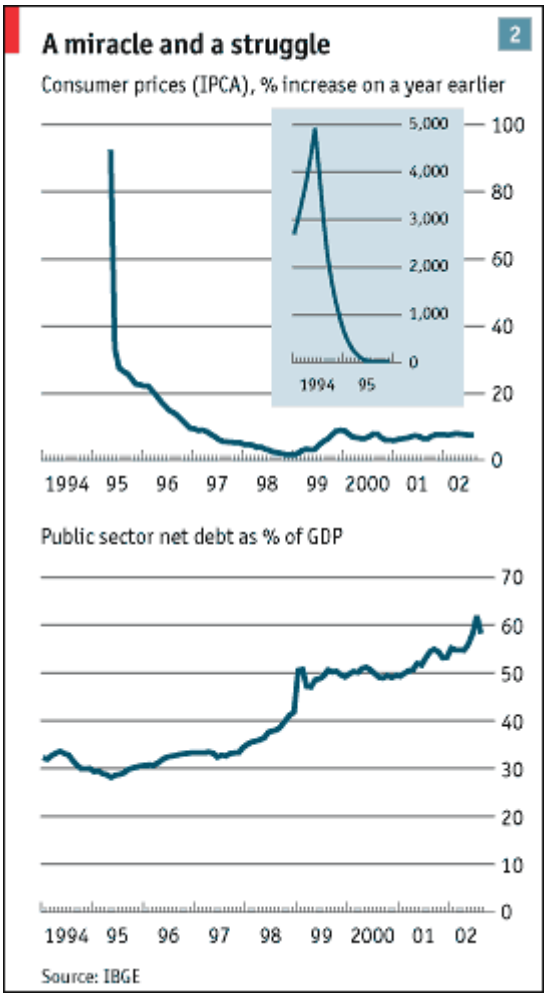
Nor has much been done on **law and order**. Many Brazilian cities, like Recife, have seen a big rise in armed assaults on motorists and other violent crimes. The country is awash in weapons, but a gun-

control bill Mr Cardoso sent to Congress in 1999 got nowhere. In 2000 he launched a broader public-security plan, including funding for crime-reduction programmes and new jails. But progress has been slow: only one high-security federal jail has been built. The rest of the prison system, run by state governments, suffers constant breakouts, riots and gang warfare.

Mr Cardoso has also been unable to get Congress to approve his proposals to reform Brazil's sluggish and sometimes corrupt justice system. The constant stream of allegations of corruption in Brazilian politics may prove that corruption has indeed worsened, or may simply mean that more is coming to light. Mr da Silva's advisers claim, perhaps extravagantly, that corruption eats up 20-30% of public spending, and promise their man will be bolder in tackling both corruption and tax evasion, thereby acquiring the money to raise social spending. The PT has a reputation for being more honest than other parties, though recent scandals in PT local governments are beginning to undermine it.

Mr Cardoso has made slower progress than he hoped in reforming the public finances. A fiscal-responsibility law, passed in 2000, is forcing formerly profligate states and municipalities to put their budgets in order. But reforms of state pensions, whose annual deficit is almost 5% of GDP, are only part-completed. Although the government has been running ever-larger primary surpluses (ie, before interest payments), Brazil's government debt has soared under Mr Cardoso, hitting a record 62% of GDP this July, compared with 30% when he became president.

As Joao Paulo, Recife's PT mayor, sees it, Mr Cardoso has failed because he has left Brazil indebted and vulnerable with a vain bid to prop up the *real*'s value artificially before being forced to devalue in 1999. In fact, though part of the debt rise was indeed caused by attempts to prop up the currency, a large chunk of it came from Mr Cardoso owning up to large liabilities that his predecessors had incurred but left off the books, and another chunk from bailing out indebted states and municipalities, something which the fiscal-responsibility law will supposedly prohibit in future.



A change of style—and substance?

Mr da Silva promises big changes if he wins the election. He is vague, however, about what they will be. In this campaign he has adopted, apparently with success, a softer “love and peace” image, as he puts it, in place of his former tub-thumping trade-unionist rhetoric. He promises to be a great negotiator, achieving things that Mr Cardoso could not, besides bringing faster economic growth and faster progress on overcoming social problems. But he is fuzzy on policy details, of which he seems to have no grasp. The current economic model, he says, must change; he does not say what he would put in its place.

As the Brazilian press has pointed out, the main candidates' programmes are both similar and vague. All promise a more active industrial policy, thus more exports, thus more growth, thus more jobs (10m in Mr da Silva's case, 8m in Mr Serra's). Beyond that, the details are patchy. Mr da Silva would be less afraid of intervening, for instance to stop state-controlled Petrobras buying foreign-made oil platforms. There will be less talk of privatisation, though the PT admits it would bring in private firms to run water services. On social policy, which the PT regards as its *forte*, in general it is simply promising more, rather than different.

There should at least be differences in style. Mr Cardoso, the smooth, cosmopolitan, polyglot academic who is in his element at international summits (his friends include Tony Blair and Bill Clinton), will give

way to a rough-edged former trade unionist who, at the age of six, made a 1,000-mile journey with his mother to Sao Paulo in a rickety wooden truck. Mr da Silva started work at the age of 12, speaks no foreign languages, and is pally with the two great outcasts of his hemisphere, Cuba's Fidel Castro and Venezuela's populist president, Hugo Chavez.

Although the PT still has its radicals, Mr da Silva and his moderate faction, “Articulation”, have a tight grip on the party leadership. This has allowed him to carry the PT with him to the centre. In this election, Lula has replaced the PT's former threat to “renegotiate” Brazil's government debt with a pledge to repay it, and indeed to maintain a primary surplus sufficient to stabilise it. Overruling the radicals' objections, he sealed an electoral pact with the small, conservative Liberal Party in order to get its leader, Jose Alencar, a textiles magnate, as his running mate. Yet trying to run the huge federal-government machine, while curbing his party's and his supporters' huge expectations, would be a far bigger challenge. The PT has some experience running states and cities, often quite efficiently, but its leader has none.

Even if Mr da Silva wins the presidency, the PT will be far short of a majority in Congress and will have to seek support from the centre. Paradoxically, Mr da Silva's most promising potential allies might be Mr Cardoso's Social Democrats (PSDB) and their main coalition partner, the Brazilian Democratic Movement (PMDB). Both these and the PT grew out of the leftish opposition to Brazil's 1964-85 dictatorship; but the PMDB and PSDB moved to the centre sooner, and formed a centre-right government with the backing of conservative groups. Now that victory looks likely, Mr da Silva has begun to put out feelers to Mr Cardoso's support base.

Given Mr da Silva's switch to more orthodox economic policies, and the chance that some parts of the current governing coalition will stay, it seems that life under President Lula might not be so different. So why are the markets panic-stricken at the prospect? As Mr da Silva's lead has increased, the *real* has fallen to record lows and the spreads on Brazil's bonds (ie, the interest investors expect on them, above that on US Treasuries) have soared. Investors' main worry is not that, once in office, Mr da Silva will rip off his moderate garb to reveal his old, fiery, socialist self and declare a debt moratorium. It is that he may be incapable of taking the tough decisions needed to stabilise the debt—imposing a further fiscal squeeze if needed in the short term, while passing difficult reforms, such as cutting the fat pensions of public servants, who tend to vote for him.

If he wins, Mr da Silva's job, whether he realises or admits it, will be to continue and improve on Mr Cardoso's unfinished package of reforms. He will have only a few months from being elected to gain the markets' confidence. It would help if he kept Arminio Fraga as head of the Central Bank, though he has hinted that he will not. But his advisers promise that he will get moving even before taking office in January: for example, pressing the current Congress to approve reforms of the growth-stifling tax system.

Mr Cardoso dreamed of Brazil following the example of Spain, which has gone from being poor and backward to wealthy and modern in the generation since its return to democracy. His country has gone only part-way during his mandate, and now Mr da Silva may have to complete the job. Intriguingly, it was a Socialist government in Spain in the 1980s that achieved many of the economic reforms that set the country on the road to growth.

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Dealing with Iraq

Open up everything, or else

Oct 3rd 2002 | WASHINGTON, DC
From The Economist print edition

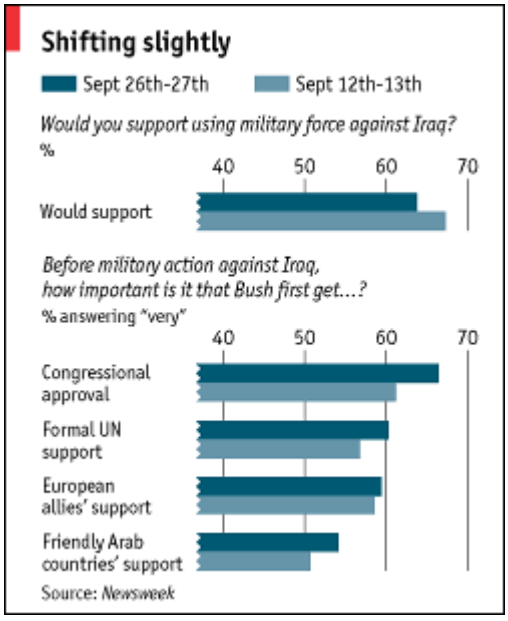
AP

Debating resolutions, at the UN and in Washington

Get article background

THE put-down could not have seemed more calculated. Barely had Hans Blix, who leads the United Nations' special inspectorate for Iraq, announced in Vienna on October 1st that agreement had been reached on practical arrangements for the return of inspectors, than America's secretary of state, Colin Powell, was telling the world that, without a tough new UN resolution, neither Mr Blix's inspectors nor those of the International Atomic Energy Agency, who have the job of checking whether Iraq is developing nuclear weapons, were going anywhere.

"We will not be satisfied with Iraqi half-truths or Iraqi compromises or Iraqi efforts to get us back in the same swamp," said Mr Powell, referring to Saddam Hussein's past practice of blocking the inspectors at every turn. Which leaves the whole problem to be tussled over once more at the UN Security Council.



There America has been canvassing support for a draft resolution that would oblige Iraq to give an "accurate, full and complete" accounting of its nuclear, chemical and biological weapons and banned missiles, including their location, any components and materials that go into them, and a list of sites and research centres where they have been developed. Inspectors would then have enhanced powers to look for them and destroy them. Iraq would have seven days to accept the terms of the resolution, and 23 more to come up with the required list. Any "false statements or omissions" would, in the American proposal, constitute a "material breach" of Iraq's obligations, bringing the authorisation of "all necessary means", including military force, in response.

Needless to say, Iraq has rejected any such resolution as entirely "unacceptable". It has long claimed that it has no weapons of mass destruction. Instead, Iraq would rather be inspected under existing arrangements, which include advance notice to be given for inspection of certain "presidential sites". Negotiating access to these sites was not in Mr Blix's remit, though the Iraqis were left in no doubt that it would be in their own interest to open up all sites, without reservation.

Russia has welcomed the agreement Mr Blix struck in Vienna. But its foreign minister, Igor Ivanov, took a tougher-sounding line this week, saying that “If any extra resolutions are required for the effective work of the inspectors, we, of course, are ready to consider them.” Russia is still unhappy with America's proposals for dealing with Iraq, but it is also keen to keep the Bush administration working through the Security Council; so it is unlikely to reject a new resolution out of hand. What is more, the principle of unfettered access is widely recognised as essential if future inspections are to seem credible, not just to America and Britain, but also to Mr Hussein.

In Washington talk of war is everywhere

Russia's talk this week of resolutions, in the plural, moves it a step closer to France. France is arguing for two resolutions, rather than one. The first would oblige Iraq to disarm, but, if it got up to any funny business again, a second resolution would authorise the use of force.

That, of course, might just be a recipe for prevarication. The two essential ingredients for inspections to work, argues Terence Taylor, head of the Washington office of the International Institute for Strategic Studies, and himself a former inspector in Iraq, are a Security Council united behind the demand that inspectors must be able to go anywhere, at any time, and the credible threat of substantial force if Iraq fails to comply. Without both, inspectors could soon find themselves, as before, having their authority whittled away by determined Iraqi obstruction.

That is also the thinking behind the American and British push for a single resolution. Unless it is made clear that defiance would bring a forceful response, Mr Hussein is unlikely to take the inspections seriously enough to hand over his banned weapons. British officials have been at pains to explain that the threat of force is vital to make inspections work; it is not an excuse for war.

As Congress wrangles

In Washington, meanwhile, talk of war is everywhere. For the past several days, Congress has been debating the most momentous subject it has faced since the 1991 Gulf war: whether to pass a resolution giving the president the broad powers that he needs to liberate Iraq from Saddam Hussein. The two houses are not expected to vote on the resolution until next week. But the debate consumes Washington.

The week started with convoluted manoeuvrings over the wording of the White House's resolution, which seemed to some legislators to give the president too free a hand. Early on October 2nd, the top four congressional leaders from the House and the Senate met with the president to thrash out the final details of a draft. Dick Gephardt, the Democratic minority leader in the House, reached a deal with the White House fairly swiftly. The bipartisan agreement gives the president most of the powers he asked for, allowing him to act without going through the UN, but it nods to Democratic concerns by encouraging him to exhaust all diplomatic means first.

Tom Daschle, the Democratic Senate majority leader, resisted the president's entreaties—attempting, it was thought, to obtain a resolution so watered-down that all Democrats up for re-election would be able to vote for it without incurring the charge of being soft on Mr Hussein. But he was quickly isolated. Four leading senators, including Joseph Lieberman and John McCain, immediately introduced the new bipartisan resolution into the Senate.

The momentum is now with the president, and there is little doubt that Republicans will line up behind him. Though divisions still exist within the party, they are being papered over in the name of electoral solidarity and out of eagerness to support the president at a time of war.

The likelihood remains that Congress will vote by a substantial margin to give Mr Bush the war resolution he wants

The divisions in the Democratic ranks are of a different order. For months the Democratic Party has been desperately trying to shift public attention away from the looming war and on to the subjects that they really care about, such as prescription drugs for the elderly. This strategy was always untenable, given the gravity of the decision that faces the country, and last week it broke down entirely.

Al Gore's speech on Iraq unleashed a pent-up tide of Democratic opposition. Mr Daschle accused Mr Bush of maligning his party's patriotism. Ted Kennedy argued that America should not act without UN approval. Three congressional Democrats—David Bonior from Michigan, Jim McDermott from Washington state and Mike Thompson from California—even went to Iraq to try to slow down, as they imagined, the

drift towards war. A collection of prominent liberals, including Tom Hayden and Ed Asner, took out an anti-war advertisement in the *New York Times*.

Republicans feasted on all this. But anyone expecting a showdown between congressional Democrats and the White House will probably be disappointed. The likelihood remains that Congress will vote by a substantial margin to give Mr Bush the war resolution he wants. Most leading Democrats recognise that blocking the president over Iraq will cause their party grief. Some Democratic spokesmen suggest that, given a few modest changes in the wording of the resolution, Mr Bush may well end up winning the support of 80% or more of congressional Democrats.

But the Iraq debate has been a disaster for them. It has shifted attention from the domestic issues that they favour. It has opened up a festering debate within the party between liberals and hard-liners. It has given the Republicans plenty of ammunition to attack them as pacifists. And it has left the impression that the Democratic leadership has no foreign policy of its own, except to raise objections.

The party's dilemma can be captured in a single opinion poll. Some 57% of self-described Democrats say that they are in favour of taking military action against Iraq; 41% oppose it. That 41% includes big party contributors. Congressional Democrats cannot take a firm stance on the war without alienating a significant part of their constituency—and without forfeiting some of the political contributions that keep the political machine in motion.

The Republicans start with a considerable advantage on foreign policy. Polls show that voters trust Republicans over Democrats on this subject by a huge margin, an advantage that matters greatly when the country is preoccupied by foreign policy. The average American is not impressed by people who are more worried about Mr Bush than Mr Hussein. Nor is he impressed by a strategy that supports war in principle but raises every possible objection to military action in practice.

The Democrats may eventually be able to salvage something from this mess. If the war goes badly, they will be able to point out that they raised questions about Mr Bush's impetuosity. If it goes well, they will be able to claim that they voted him the war powers he asked for (if that is indeed what they do). But for the time being, the war is profoundly troubling a party that ought to be making solid advances in the mid-term elections.

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The economy

Going down?

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Evidence suggests that the economy is getting weaker

AP

AMERICA'S business economists remain a resolutely upbeat lot. In their latest forecasts, released on September 30th, members of the National Association for Business Economics promised "solidly positive" if not "supercharged" economic growth. They dismissed as "remote" the "perils that grab headlines", including a double-dip recession, deflation or a housing-market bubble. Only one of the 32 business forecasters surveyed expects the Federal Reserve to cut interest rates in the next few months.

Unfortunately, this optimism does not seem to be widely shared. Apart from a sharp one-day rally on October 1st, stock markets have been sliding inexorably downwards, and bond yields keep falling. Yields on ten-year Treasury bonds have fallen to 40-year lows, and, early this week, the yield on two-year Treasury bonds fell below the 1.75% federal funds rate. Forward prices suggest that financial markets expect the Federal Reserve to cut its short-term federal funds rate to 1.25% by February. Some people on Wall Street are now speculating that the Federal Reserve will cut rates before its next scheduled meeting on November 6th.

Many recent statistics justify the gloom. America's manufacturing industry appears to be tipping back into recession. The Institute for Supply Management's monthly survey of purchasing managers—perhaps the most widely watched indicator of manufacturing activity—slipped to 49.5 in September from 50.5 in July and August. Any reading below 50 implies that factories are slowing down. Although a slipping IMS index is not a foolproof gauge of recession, it suggests that the eight-month recovery in America's manufacturing may well be faltering. A separate survey of manufacturing in and around Chicago was even gloomier.

Faltering manufacturing growth is not a good sign, but it is not the switch that would tip the whole economy back into recession. The main bulwark against a double dip remains the consumer. With firms' investment spending in the doldrums, Americans' willingness to reach into their wallets provides the sole support for economic growth.

The bad news is that all measures of consumer confidence are wavering

The signals for consumption are mixed. The bad news is that all measures of consumer confidence are wavering. One set of weekly surveys shows consumer sentiment at eight-year lows. The University of Michigan consumer-sentiment index fell for the fourth consecutive month in September, though less dramatically than many expected. After a spurt of summer spending, particularly on cars (with auto firms once again offering 0%-interest financing deals) and durable goods (to furnish all those houses that Americans are buying or doing up with mortgage rates at historic lows), people seem to be retrenching. According to statistics released on October 1st, vehicle sales fell back sharply to an annual rate of 16.3m cars, from 18.7m in August. A drop was inevitable after the zero-interest-rate splurge, but does not bode well for the future.

In America's shopping malls, the spending news is even gloomier. The Bank of Tokyo-Mitsubishi index of chain-store sales fell sharply last week: they are running a mere 2% above a year ago. Even the mighty Wal-Mart has lowered its projections. Although chain-store sales are not a perfect indicator of overall spending patterns, they are yet another signal of gloom. Against this background, many Wall Street economists now reckon that growth will slow down sharply in the last three months of the year.

Stay robust! It's easy to say that...

The main argument against all this gloom is that Americans' incomes are still rising strongly. According to statistics published by the Commerce Department on September 30th, total after-tax disposable income (which includes wages and salaries, health benefits and capital gains) rose 2.3% over the past year in real terms (see chart). In striking contrast to the previous recession in the early 1990s—when disposable income fell by 1%—overall income growth has remained strong.

This does not mean, of course, that all families are better off. A batch of recent statistics shows that the slowdown has been hurting the typical American household. The latest annual poverty figures (which also define income differently from the Commerce Department) showed that median household income fell 2.2% in 2001, the first drop since 1991. America's overall poverty rate rose from 11.3% in 2000 to 11.7% in 2001, the first rise since 1993.

This rise was mainly concentrated among white people and in the suburbs. By contrast with previous recessions, child poverty remained unchanged, as did poverty among blacks and Latinos. Another new set of statistics, released on September 30th, showed that the number of Americans without health insurance rose in 2001 to 41.2m, as small companies, in particular, cut back benefits in the face of recession and the rising costs of health care. The number of uninsured had fallen in the previous two years.

If the economy stalls, these poverty and health-care numbers will almost certainly worsen. For optimists, including Bush-team officials, the key to avoiding such gloom is solid consumer spending, based on low unemployment and strong overall income growth. But is the typical American, laden with debt and worried about his job, ready to be that robust?

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Maryland politics

Connie's conundrum

Oct 3rd 2002 | WASHINGTON, DC
From The Economist print edition

Nice congresswoman, shame about the party

IN A Democratic Utopia, all Republicans would be just like Congresswoman Connie Morella. Since 1986, Ms Morella has beaten back every Democratic challenger for her seat in Maryland's liberal 8th District, a suburb of Washington, DC. But this year Democratic voters may notice that, even though she supports their causes, she sits on the wrong side.

Ms Morella has been popular among her constituents, who tend to be civil servants and professionals. They were happy with a Republican who sided with Democrats on the environment, health care, foreign policy and union rights. She is one of a handful of House Republicans who have publicly expressed uneasiness about Mr Bush's plans for Iraq, and she has defied him by defending federal workers' rights in the proposed Department of Homeland Security. Lawn signs for her campaign remind voters of her friendliness, simply saying “Connie!” She has been endorsed by many liberal groups, from the green Sierra Club to the powerful Brady gun-control campaign. And her campaign coffers contain almost $2m.

Nonetheless, Ms Morella is considered the most vulnerable Republican running on November 5th. Democrats, annoyed when she felled yet another of their candidates in 2000, ensured that her district was redrawn with three new Democratic neighbourhoods and without its few conservative ones. She must now contend with an electorate that is almost 70% liberal-leaning, a lot more than in 2000.

Ms Morella is considered the most vulnerable Republican running on November 5th

The Democrats have also ensured that she faces strong competition in Chris Van Hollen, a Maryland state senator. He hopes to exploit Democratic anger over how aggressively Republican leaders have pushed their agenda. Mr Van Hollen contrasts his legislative acumen with Ms Morella's inability to shape legislation from the ideological backwoods of her party. “There is a difference between voting a certain way and leading the fight,” he says. He suggests, for instance, that Ms Morella would not be able to get federal money for the district's badly needed transport improvements. He also plans to draw attention to how often Ms Morella falls into line with the Republican leadership, particularly on economic issues such as the giant 2001 tax cut.

Ms Morella contends that her constituents value her as a moderate who can resolve party differences. But in the tensely partisan mood of this election year the Democrats may be hardening. On October 1st, the National Organisation of Women (NOW) endorsed Mr Van Hollen on the ground that “the ascension of right-wing leadership in the House” has made Ms Morella irrelevant. It was the first time since she took office that NOW has endorsed her opponent.

To be sure, the race is far from over. Mr Van Hollen must replenish his campaign fund, which at the moment contains only a miserly $200,000. Two events this week, featuring Senator Hillary Rodham Clinton and Congressman Dick Gephardt, will no doubt help on this front. Between them, the two parties have raised a total of $6.6m (including the money for their primary elections). The Centre for Responsive Politics says this is the costliest House contest.

Some sceptics doubt whether the Democrats in the new district will actually turn out to vote, since they are mostly blacks and Latinos, groups with notoriously low turn-out rates. Quite a few of them may not even be eligible to vote. But if they are, Ms Morella must be hoping that her party does not eclipse her.

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Black politics

Home truths from the Barbershop

Oct 3rd 2002 | BROOKLYN AND WASHINGTON, DC
From The Economist print edition

Young black politicians are singing a different song

“BARBERSHOP”, a new comedy written, directed and acted by some of the best black talent, has grossed over $51m in the past three weeks. “Upbeat”, “warm-hearted” and with a nice line in redemption—so the critics say—it depicts a young man's “empowerment” through a barbershop he inherits from his father. The Revs Jesse Jackson and Al Sharpton, two of the most vocal champions of the black civil-rights movement, want it censored.

The offending matter is a few scenes in which a particularly gruff veteran barber, Eddie (played by Cedric the Entertainer), skewers some of the movement's most revered black leaders. He calls Martin Luther King a “ho” (lady of the night, in Harlem-speak), claims Rosa Parks was simply too tired to move to the back of the bus (“Ain't do nothin' but sit her black ass down”) and admits that “O.J. did it.” “You better not let Jesse Jackson hear you talk like that,” one of his colleagues says, to which Eddie replies “Fuck Jesse Jackson!” At this point, the black audience in this correspondent's Brooklyn cinema—which had been laughing heartily the whole time—erupted.

Within a week of the film's opening (and, it is said, without seeing it for himself), Mr Jackson released a statement declaring that the King and Parks families had been insulted, and insisting that MGM Studios, which produced the film, cut the scenes from future videotapes and DVDs. The film's producers, writer and director have apologised, but sensibly refused to make the cuts.

The scuffle reflects a much larger shift in the self-consciousness of black Americans. This new generation is grappling with the troubles of the inner city, not Jim Crow, and “Barbershop” is about blacks taking control of their lives. The same divide could be seen on September 13th in Washington, DC. There, while Mr Jackson was leading a raucous march against the Justice Department, the Congressional Black Caucus (CBC) at its annual convention was listening to young stars such as Harold Ford junior of Tennessee and Cory Booker, the ex-challenger for mayor of Newark, calmly debating health-care policy and opportunities for investment.

The new leaders reflect the scepticism most young blacks feel about government. In a study by the Joint Centre for Political and Economic Studies, 27% of middle-aged blacks said they had a great deal of confidence in the federal government; among those under 35, only about 6% do. Young blacks are more likely than middle-aged ones to call their views conservative rather than liberal. A study from Black Entertainment Television (BET) shows that young blacks are least likely to want the government to give them special help.

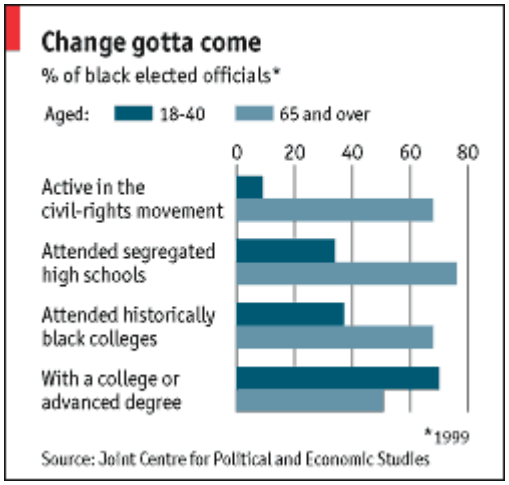
This new generation is grappling with the troubles of the inner city, not Jim Crow

Young black officials want to offer poor blacks not welfare, but business opportunities. They also want to encourage blacks to invest much more of their $600 billion a year of disposable income. Blacks' savings are disproportionately low; a BET study released in August showed average black net household wealth at $15,500 a year, compared with $71,700 for other Americans. Yet a new study by the Kauffman Foundation, released on September 24th, found that blacks were 50% more likely to try starting a business than whites.

Leaders such as Messrs Ford and Booker often attribute their political acumen to spending more time in school. Some 70% of black elected officials aged between 18 and 40 have at least a college degree (see chart), compared with 51% of those over 50. Many of them also had parents in politics, from whom they learned at first hand the arts of compromise, favour-trading and coalition-building.

Their parents, though, were often ideologues, whereas the new

bunch are not. In the House last year, Mr Ford, a congressman's son, persuaded his black colleagues to support a campaign-finance-reform law they disagreed with, recognising that the Democratic Senate would adjust the bill in conference. “We can't be on the wrong side of this,” he said. In congressional primaries this summer, two outspoken symbols of the civil-rights generation, Earl Hilliard of Alabama and Cynthia McKinney of Georgia (their shrillness no less embarrassing because they sat in districts gerrymandered to produce a black majority), lost to moderate, quieter black opponents.



Despite being centrist, the new leaders are still overwhelmingly Democratic (the Republicans' lone black congressman, J.C. Watts, is retiring this year). With their mixture of progressive and pro-business thinking, they find the moderate wing of the Democratic Party a natural and welcoming home. Al Gore, a fellow-Tennessean, recognised Mr Ford's potential early, getting him to deliver the keynote address at the 2000 presidential convention. The Democrats are even considering holding their 2004 party convention in Detroit, not least because the mayor of that city is a charming 32-year-old black man who courts high-tech businesses.

So what will happen to the quintessential black leaders, such as ancient John Lewis of Georgia and Harold Ford senior? Some of them, like Mr Lewis, seem to welcome the fresh air; others, like the ousted Ms McKinney, are furiously fighting it. It seems odd that civil-rights leaders, who struggled so long for all races to have equal opportunities, should now resent the fruits of that labour. But a spokesman for Mr Jackson may sum up the sentiment: it is easy for young blacks to say they will not march any more, because they never had to march in the first place.

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Crossing the border

Just step this way

Oct 3rd 2002 | SAN YSIDRO, CALIFORNIA
From The Economist print edition

Good neighbours need good fences—and good bridges

“YOU see that ditch? I bought that ditch because it's the Embarcadero”, the landing-place. Sam Marasco, who is pointing at a scruffy strip of land 40 feet below the scaffolding tower on which he stands, sees the gleaming future of his purchase, not its dusty present. To understand his optimism, look the other way, across the sun-baked roofs of the “factory outlets”, big shops selling cut-price goods, which stretch across the rest of his land. A year ago, this too was just scrubby desert hugging the foot of the steel fence that runs along America's southern border.

The shopping mall at Las Americas, as Mr Marasco calls his project, opened in November and is already doing well. Its monthly sales are twice the national average. Two figures picking their way carefully alongside the ditch, bulging plastic bags in either hand, give a clue to where some of this business is coming from. They are walking towards the border station at which they will cross back into Mexico, laden with sneakers, clothes and electronics bought on the American side.

The tower from which Mr Marasco shows visitors his plans marks the site on which he hopes to plant one end of a new footbridge. The other end would sit in Mexico, on the Avenue of Heroes, whose triumphal arch is visible across the border. The bridge would link Las Americas with the centre of Tijuana, saving people a half-hour walk across many lanes of traffic.

Making life easier for people who want to cross the border seems a quixotic idea at a time when America is trying to protect itself against terrorists. As he points to the proposed line of his bridge, Mr Marasco's arm sweeps over a team of government workmen steadily adding steel plates to the fence that marks the international border, raising it another six feet. The number of guards on the border, and the cost of watching it, have tripled since 1995. But Mr Marasco is confident that his plan can be squared with tight security. Simplifying the passage of those who have the right to cross the border, he argues, will free men and money to stop those who do not.

The State Department, which conducts the negotiations necessary to set up new international links, is inclined to agree. Mr Marasco has visited Washington several times to explain his plans to the federal agencies that would be involved.

Making life easier for people who want to cross the border seems a quixotic idea at a time when America is trying to protect itself against terrorists

The bridge would include new checkpoints, built by the Las Americas project and staffed by customs and immigration officials. Since October 1st, all Mexicans crossing the border have had to carry a card that includes not only a photograph but biometric data which can be optically scanned. The big problem at the moment is whether enough officials will be available to deal with all this. After the September 11th attacks many agents were moved up from the Mexican border to the understaffed Canadian one.

Already lots of people travel back and forth across the border each day. Some live on one side and work on the other; some have houses on both sides; some cross to shop, or in search of entertainment. But the existing arrangements—clanking cage-doors and dusty car parks—treat the border as the dead end of each city.

It was not always so. When John Spreckels founded the San Diego and Arizona railway in 1906, to complete a direct route across the continent, the cheapest way around the hills to the east of the city was to loop south through Mexico for the first few miles. The track now stops at the border. But, a century later, San Diego is happy to greet shoppers from the south.

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The attack on evolution

On the sixth day, post-modernism

Oct 3rd 2002
From The Economist print edition

A suburban school board declares that evolution is just another theory

NEWT GINGRICH, while he was a Georgia congressman and then as speaker of the House, was known for his interest in scientific research. Some Georgians prefer a different approach. On September 26th the school board of Cobb County, in the north-western Atlanta suburbs, voted to amend existing policy to allow discussion of “disputed views of academic subjects”, specifically the idea that God created the universe in six days—Charles Darwin, Stephen Jay Gould and the rest of them be damned.

The vote came after a month of deliberation, at a meeting crowded with concerned parents. Some 2,000 of the county's residents signed a petition last spring to have the board put stickers on biology textbooks telling students that evolution is a theory, not a fact. “What they're trying to do is appease the religious right,” says Michael Manely, the lawyer representing a local parent who wanted the stickers removed.

The war between creationists and evolutionists had recently fallen quiet. In 1999, the Kansas state board of education dropped evolution from state examinations; but by 2001 the three most prominent anti-evolutionists had been voted out of office, and the decision quietly reversed. Of late, the Christian right has focused on other topics. But the anti-evolutionists' victory in Cobb County may stimulate similar-minded people elsewhere. In Ohio, the state board of education is under pressure to include “intelligent design”—the idea that the complexity of the universe proves the existence of the divine—when it issues a new science curriculum.

Cobb County's new policy argues that providing information on “disputed views” is “necessary for a balanced education” and will help to promote “acceptance of diversity of opinion”. A poll commissioned in 2000 by People for the American Way, a liberal-minded group, shows that many Americans think this way. Nearly half of the respondents believed that the theory of evolution had not yet been proved. And of those who believe in evolution—only a fifth wanted evolution taught alone—three-quarters liberally agreed that students should be presented with “all points of view” and “make up their own minds”. In this post-modern reasoning, evolution and the Book of Genesis are equally valid.

The losers have already begun worrying aloud that this will hurt Cobb County's reputation as a place where children can get a good education. Cobb's schools consistently rank above the state average, which is not saying much. But what happens if superior schools insist that previously accepted facts have become mere theory? No comment from Mr Gingrich, who now lives in Virginia.

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Lexington

Mephistopheles and the Torch

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From The Economist print edition

Robert Torricelli's fate points to something rotten in money-politics

HERE we go again. Two years ago, a fiendishly close presidential election ended up in the courts. This year's battle for the Senate may also be decided by the judges. The Democrats' single-seat majority in the Senate depends on the result of about nine races. Now Robert Torricelli has been forced out of the New Jersey contest, prompting a tortuous legal battle over who is allowed to replace him. Once again, we are in the world of electoral rule books, judicial appeals and absentee ballots.

Even in the home state of television's Tony Soprano, the snuffing out of “the Torch” has been a dramatic piece of political brutality. Mr Torricelli, a flashy, garrulous figure with a genius for raising money (in “The Sopranos” he would have been a Mob accountant with an eye for the ladies), had a 14-point lead in the opinion polls in June over an unknown Republican, Doug Forrester. But he has been battered by a series of allegations about illegal gifts from a Chinese-born businessman, David Chang. By last weekend Mr Torricelli was 13 points behind. For the Democrats, it was not just a question of losing a safe seat; it was also the money they stood to lose trying to relight the Torch.

The final scene was an odd mixture of chaos and pathos. Mr Torricelli's farewell speech in Trenton was repeatedly delayed amid rumours of second thoughts and backstage deals. Eventually he emerged to pledge that he would “not be responsible for the loss of the Democratic majority in the United States Senate”, before demanding, “When did we become such an unforgiving people?” This brought a tear to the eye of a blonde moll behind him, a hug from the Democratic governor, Jim McGreevey, and wry giggles from the press at the back of the hall.

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The political world is less interested in the whys and wherefores of Mr Torricelli's fall than in what happens next. Mr Torricelli quit just 36 days before the election; his name already appears on absentee ballots. The Democrats, after a frantic day of telephoning and three refusals from people they fancied, eventually chose Frank Lautenberg—who has been New Jersey's Democratic senator before, and is not far off 80—to replace him in November. The New Jersey Supreme Court said on October 3rd that this was fine; the Republicans hotly disagreed and went straight to the Supreme Court in Washington. They point out that the deadline for such changes was September 15th and that, as Mr Forrester put it, state law has no “we-think-we're-

going-to-lose-so-we-get-to-pick-someone-new” clause.

And that is just the beginning of the complications. If Mr Torricelli cannot be removed from the ballot, he can resign, which might mean postponing the election. Alternatively, he could run, promising to resign once elected. Such complications happened recently in Missouri, where voters elected a dead man, Mel Carnahan, knowing that his wife, Jean, would be appointed in his stead. But why should voters trust Mr Torricelli? Unlike the dead, he can still speak, and he detests Mr Lautenberg.

All the same, Mr Torricelli has done his party a favour this week. The Republicans looked certain to win the seat; now the Democrats at least have a chance, partly because Mr Forrester's entire campaign has been based on the idea that he is not Mr Torricelli. If the Democrats contortedly scramble their way to a win, they should be grateful to the Torch.

Why this is hell, nor am I out of it

But why did he get into the mess in the first place? Amid all the frantic manoeuvring, the issue of corruption has been forgotten. Mr Chang claims that there was a deal: he would give cash to the senator and his 1996 election campaign, and Mr Torricelli would lobby to get the North Korean government to repay an $85m loan to Mr Chang. Mr Torricelli survived a criminal investigation. But the Senate Ethics Committee “severely admonished” him, and FBI investigators have said they believed Mr Chang.

Most of the attention has been on the money and gifts that Mr Torricelli and his ladies allegedly got—the Italian suits, an $8,100 watch, and so on. But that ignores why the senator was drawn to Mr Chang in the first place: his near-pathological need to raise money. In fund-raising terms, Mr Chang was an easy mark: a foreigner who thought that you had to spend money to get things done. Mr Torricelli hit him time and again.

For that was what Mr Torricelli was truly good at. In 1996, he raised more money than any other senatorial candidate. He then brought in $100m to the Democratic Senatorial Campaign Committee; indeed, only this week he was angrily reminding colleagues that he had raised more money for the DSCC than any three other senators combined. Mr Chang may be the only one in jail, but six others have also admitted making illegal contributions to the Torricelli campaign.

By most standards, American politics is cleaner that it was: it is certainly much more transparent. But the relentless search for cash will always blur the lines. The problem is that the money is essential. This year, Gray Davis, that far-from-flashy governor of California, will spend $50m on a statewide race. He has been accused of running a “coin-operated governorship”, but will probably win. Another governor, George Ryan in Illinois, was not so lucky: his staff raised money for his campaign by selling dodgy truck-driving licences. One of the lorries ended up killing children. Mr Ryan, who may yet win a Nobel prize for his moratorium on the death penalty, has not even tried to run again.

In the end, the snuffing out of the Torch has less to do with Tony Soprano than with Dr Faustus. Mr Torricelli was offered the world, but only if he was prepared to sell his soul. Sooner or later he crossed the line, and Mephistopheles called him up to collect the prize. On the final day in Trenton, the hapless senator was probably like Faustus trying to postpone his fate (“Now hast thou but one bare hour to live/And then thou must be damned perpetually”). But so long as American politics remains marinated in money, the devil will always have the upper hand.

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Health care in Canada

Theatre of discontent

Oct 3rd 2002 | TORONTO
From The Economist print edition

Despite extra funding, one of the world's best health-care systems is showing signs of wear and tear

Winnipeg Free Press

WINTER rarely comes this early to the balmier bits of Canada, but a chill has already settled over the country's health services. On October 1st, doctors in Newfoundland shut their surgeries, refusing to treat all but emergencies, hospital in-patients and expectant mothers. In Saskatchewan, 2,500 pharmacists, paramedics and ancillary workers have entered the third week of a walkout. In Quebec, meanwhile, general practitioners are fuming at a new provincial law which requires them to provide services at far-flung, understaffed emergency rooms on top of their normal work.

Canadians are both proud of, and chronically anxious about, their health system, known as Medicare. As enshrined in the Canada Health Act it aspires to combine the public spirit and universal coverage of Britain's creaking National Health Service with the quality of America's high-tech medicine. It does this through delicate balances between public and private funding, and provincial and federal power. “Medically necessary” hospital treatment and doctor services are publicly financed, making up 71% of Canada's C$95.1 billion ($64.3 billion) spending on health care in 2000. But other medical goods and services, such as drugs dispensed outside hospitals, are not always covered. Since their cost is rising, there are calls for a national publicly-funded insurance scheme for these expenses.

But the politics of health are complex. Each province has its own definition of “medical need”. It is the provinces, too, that organise and provide health care, raising revenues to pay for it through local taxes, and disbursing money to providers according to local fee scales. The federal government chips in with payments aimed at ensuring that spending per head on health is the same in rich provinces, such as Alberta, as in poor ones like Newfoundland.

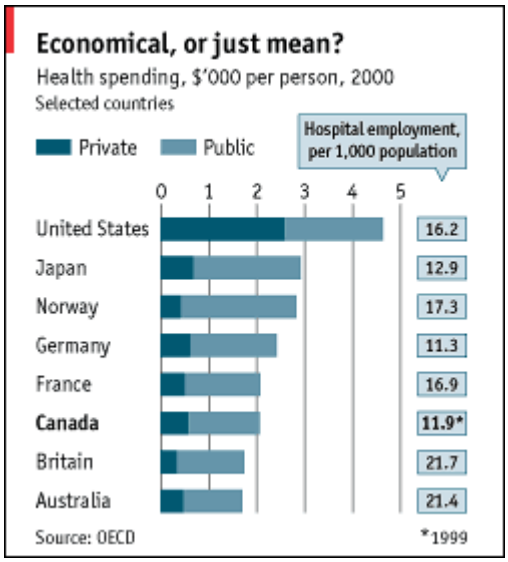
To conservative critics, this is a straitjacket that stifles innovation. Alberta, for example, is experimenting with private for-profit provision of publicly-funded services. On October 1st, Action Democratique du Quebec, a rising force in that province's politics, called for greater private involvement in providing and paying for health services, to increase choice. But these are still minority views. Most Canadians would agree with Adrienne Clarkson, the governor general, when she calls Medicare “a practical expression of the values that define us as a country”. Translation: in health care, Canadians do not want to copy the United States.

But paying for health has risen to the top of Canada's political agenda. In both Newfoundland and Saskatchewan, the strikers complain that their wages are lower than those in neighbouring provinces, leading to staff shortages. The provinces blame the federal government in Ottawa. Last week, Canada's 13 provincial premiers began an advertising campaign to publicise their complaint that the federal share of health spending has fallen by almost three-quarters over the past 20 years, to 14% of the total (30% says Ottawa).

Traditionally, the federal government has used its financial leverage to cajole the provinces to apply the principles of the Canada Health Act. “But if the federal government wants to carry a big stick,” says Michael Decter, of the Canadian Institute for Health Information, “it is going to have to write a big cheque as well.”

Recently, Jean Chrétien, the prime minister, has opened the cheque book. Two years ago, on the eve of an election and with the federal finances in good health, he promised to pour an extra C$21 billion into Medicare by 2005. With the provinces chipping in more too, the freeze in health spending of the 1990s has been reversed. Even so, in a speech opening the new session of parliament this week, Mr Chrétien promised there would be yet more money for health in the next budget.

So far, much of the new money has gone into wage settlements for health workers. Despite this, Canada still lags behind many other industrialised countries in health-care spending per head (see chart), with fewer doctors, nurses and fancy bits of equipment. The result: doctors are stressed, and patients fed up at having to wait weeks for specialist consultations, high-tech scans or elective surgery such as hip replacements.



Once in the system, however, patients seem satisfied with their treatment. According to the first-ever national survey, published on September 30th, almost 85% of Canadians rated their health services as very good or excellent. On some clinical measures, such as deaths from colorectal cancer, Canada scores far better than bigger spenders such as Germany.

Spend, then reform

Still, more money will do little to ease staff grievances unless management and working practices are reformed, argues Steven Lewis of Access Consulting, a policy consultancy in Saskatoon. Others point out that one cause of staff shortages is the decision taken a decade ago to cut places for training doctors and nurses, based on flawed projections of future demand. This could be made good by delaying retirement and licensing more foreign doctors (many now work as taxi drivers in Montreal or janitors in Toronto). Or the politicians could challenge the doctors to accept more efficient practices, such as better use of nurses. Quebec might come up with more creative ways of getting doctors to its rural areas than its current method of sending bailiffs to force them to go.

Faced with this icefield of vested interests, Mr Chrétien last year deftly shunted the issue of reform to a commission on the future of health care led by Roy Romanow, a former premier of Saskatchewan. Mr Romanow says that his report, due in November, will offer policy prescriptions (complete with cost estimates and timetables for implementation), not just on such matters as how to deal with waiting lists, but on the underlying political options facing Canadians. These include how to balance demands for more consumer choice through health-care privatisation with calls for greater social equity through public financing, and how to reconcile national standards with local needs.

Mr Chrétien has said he will convene a premiers' meeting early next year, to discuss the Romanow proposals. But Canadians should not hold their breath. “Health care is Canada's third rail, the one politicians hate to touch,” Gary Mar, Alberta's health minister, says. A little shock therapy might be just what the doctor ordered.

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Politics in Argentina

Delinquent

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Tackling crime needs police reform

Reuters

Fear and loathing in Buenos Aires

STILL reeling from a four-year economic slump, Argentines now have another big worry: a wave of violent crime. Every day, the media carry grisly details of robberies, murders and kidnappings. Last month, thousands took to the streets of Buenos Aires for a protest march against crime—and the role of the police in some of it. But just how bad has the problem got?

Excitable journalists, such as those at Radio 10, the leading station, have suggested that Argentina is heading the way of Colombia or Brazil, with violent death and kidnaps becoming endemic. Juan Jose Alvarez, the justice minister, dismisses such talk as an “exaggeration”. He is right that crime in Argentina has yet to reach the levels elsewhere in Latin America. But that is small comfort. “People don't compare their situation to that of other cities, but to the change in their own lives,” he says.

By that measure, the quality of life in Buenos Aires, formerly Latin America's safest capital, has been declining for a decade. In Buenos Aires province, which includes the capital's depressed suburbs and is home to one Argentine in three, recorded crime has more than doubled since 1991.

Contrary to public perception, however, the incidence of most crimes has not risen over the past three months, says Marcelo Sain, the province's under-secretary of security. Figures for the capital's wealthier inner core also show falls in many crimes since July—perhaps because Mr Alvarez has ordered a lot more police on to the streets. In the surrounding province, what has increased, says Mr Sain, is kidnaps, mafia-style killings (still only a handful), and “media coverage that has nothing to do with the reality of the crime situation”. He claims that such media stories have been whipped up by opponents of Felipe Sola, the province's Peronist governor, who is seeking a second term next year.

Such official reassurances are disbelieved by the many ordinary Argentines who have been recent victims of crime or know someone who has. Many, perhaps most, crimes go unrecorded. That is because the police, and especially the notorious Buenos Aires provincial force (known as the *Bonarense*), inspire fear as much as confidence among law-abiding citizens.

Since Argentina's military dictatorship of 1976-83, the police have been involved in organised crime. “In the last decade there has not been any major illegal business without police participation, from prostitution to gambling, robbery or kidnapping,” says Maria del Carmen Verdu, a lawyer at the Centre for the Prevention of Police Repression, a pressure group.

Mr Sain disputes that. He says that his police are no longer involved in criminal gangs. But he admits that around a tenth of the *Bonarense*'s 44,000 members have been accused of abuse or corruption. Accusations range from collecting fraudulent payments for services not provided, to theft of vehicles, murder and rape. Officers from the force are suspected of involvement in a particularly grisly kidnap in July. Meanwhile, last month, a youth drowned when thrown into a river after being arrested and robbed by federal police (12 of whom are being held over the case).

Ms Verdu claims that police death squads still exist. In one case, several officers have been charged with using local juvenile offenders to burgle the homes of those who refused to pay protection money. The youths were subsequently tortured and murdered. A macabre photo album of the victims was apparently

used to promote the effectiveness of the officers' private “security agency”.

Mr Sain dismisses this as an isolated case. He also claims that Mr Sola's administration is reforming the *Bonarense*'s outdated organisation. As well as a refusal to tolerate abuses, it has introduced new procedures, such as crime mapping to pinpoint trouble spots. But the regime has only been in place for three months and Mr Sain admits that improvement will “require political will, consensus and time”. Argentines can only hope that all of these will be available.

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Mexico's film industry

The Mexicans are coming!

Oct 3rd 2002 | MEXICO CITY
From The Economist print edition

Americans take to Mexico's movies

AMERICANS have developed a taste for many things Mexican, including tacos, salsa and maids. But the latest successful Mexican export is more surprising: arty films. Over the past few years, Mexico's film industry has enjoyed a small renaissance. Americans have started to take note.

The next test of this will be “El Crimen del Padre Amaro” (The Crime of Father Amaro). Released in Mexico in mid-August (just after the pope's visit), it has already become the country's highest-grossing film, taking $14m. That owes much to an attempt at censorship. Its subject is a young priest working his way through a full litany of unpriestly behaviour, including encouraging his girlfriend to get an abortion. But the film's most powerful element is its portrayal of the church hierarchy as being in league with mobsters and drug traffickers. The Catholic bishops commanded their flock not to see it. This merely provoked a predictable stampede to the cinema queues.

“El Crimen del Padre Amaro” is due to open in 50 cinemas in the United States on November 15th. Its American distributors hope to capitalise on the recent success north of the border of two other Mexican films, “Amores Perros” (Love's a Bitch), a bleakly violent urban drama, and “Y Tu Mama Tambien” (And Your Mother Too), a sexy comedy. Both broke records in Mexico, the first grossing $9.5m and the second $11m. The surprise was that “Y Tu Mama Tambien” made still more ($13.6m) across the border.

Following the path opened up a decade ago by “Like Water for Chocolate”, a magical-realist love story, such movies have transformed foreign perceptions of Mexican film. But they have not yet transformed the local film industry. All these films were low-budget efforts. “El Crimen del Padre Amaro” cost only about $2m to make. Mexican films may be as fashionable with New York arthouse audiences as French or Italian films were 30 years ago, but their lack of expensive Hollywood stars restricts their distribution.

In the 1940s and 1950s, Mexico had a huge mass-market film industry—as well as arthouse directors, such as Luis Buñuel, a refugee from Franco's Spain. Its studios churned out Mexican westerns and romantic dramas, which dominated screens throughout the Spanish-speaking world. Now, a similar sort of effort goes into producing television soap operas. These do well abroad, including in some unlikely places (such as China), though they lack the quality of their Brazilian rivals.

But the arthouse movies do herald a broader, if still modest, revival of Mexico's film industry. Like Canada, Mexico has become a favoured (because cheaper and union-free) location in which to make Hollywood movies. This has fostered a new generation of Mexican technicians. Parts of “Titanic” were filmed there, despite the lack of icebergs. Time, perhaps, to remake those westerns.

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The Caribbean

Hung up on getting strung up

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A demand for the death penalty

WITH 726 violent deaths since January in a country of 2.6m, Jamaica's prime minister, P.J. Patterson, who faces a general election on October 16th, wants to change his country's constitution to make it easier to hang convicted murderers. He has company. Barbados passed a pro-hanging constitutional amendment on September 4th, and Belize expects to do so by December.

Across the Caribbean, voters press politicians to “do something” about violent crime. Hanging murderers is an easy idea to grasp. Although the death penalty is on the statute books almost everywhere, it is rarely used. For this, voters and politicians angrily blame Britain's Privy Council, which serves as the region's highest court of appeal.

The Council has certainly made hanging harder. For example, it has ruled that the death penalty must be commuted if appeals have delayed executions by five years or more, or if the trial judge had no discretion in sentencing. And it insists that states which join international human-rights bodies must comply with their processes. But the Privy Council does not block the death penalty when all conditions are fulfilled, as they were with ten condemned men in Trinidad in 1999, and with two in the Bahamas in 2000.

Mr Patterson and most of his regional colleagues want a new Caribbean Court of Justice to replace the Privy Council. Preparations are well advanced. A temporary headquarters is ready in Trinidad. In July, the required three regional governments ratified the treaty to set up the court—St Lucia, Barbados and Guyana. If the Caribbean Development Bank can raise $100m to fund it, it could start work by the end of 2003.

Not everyone favours the switch. Jamaica's opposition leader, Eddie Seaga, has called the Privy Council “the best court in the world”. In Antigua, where the Council has several times thwarted the government in civil-liberties cases, change requires a referendum, and would be unlikely to succeed. And from the Bahamas, a court in Port of Spain looks almost as remote as a London one. Some Caribbean lawyers argue that the Privy Council is fast, impartial, efficient—and does not charge for its services.

Few reckon that a new appeal court will in itself bring down the crime rate. The causes of crime are complex. Police, prisons and lower courts need equipment and staff. Violent criminals are deported from North America, bringing the wrong skills. Young people lack jobs. And politicians must share the blame. In Jamaica, they have long cultivated links with local drug gangs. And in Trinidad, a former pro-hanging cabinet minister is now himself on trial for murder.

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Pakistan's election

Khaki election

Oct 3rd 2002 | ISLAMABAD
From The Economist print edition

It is billed as the restoration of democracy. But Pakistan's election will usher in something rather different: a new period of tension between soldiers and civilians

“TRUTH is the biggest casualty in Pakistan,” observes the country's president, Pervez Musharraf. Well, yes, but who is molesting it? Is it the chorus of politicians, journalists and activists who insist that the elections to be held on October 10th to the National Assembly and the legislatures of the four provinces will be a fraud, and that the governments they induct will be at the mercy of the president's whims? Or is it General Musharraf himself, who insists that after three years of ruling Pakistan single-handedly he has introduced “real, sustainable democracy”?

Neither side is wholly innocent of distortion but the president's critics have a point. The elections are unlikely to be fully free or fair, and the government they bring in will face an uncomfortable choice between submitting to the president and confronting him head on. The elections will end the formal monopoly of power that General Musharraf, who is also head of the armed forces, has enjoyed since he ousted the last civilian prime minister, suspended the constitution and unseated the parliament and the provincial assemblies. Prime minister, constitution and parliament will now all return. But the general and his army chiefs will continue to have much say over how Pakistan is run.

The meddling starts with the conduct of the election itself. Pakistan's two top politicians are not in the race, nor even in the country. Nawaz Sharif, the prime minister General Musharraf deposed in October 1999, is in exile in Saudi Arabia, a fate he preferred to the punishment the army had in store for him. Benazir Bhutto, another two-time prime minister, is avoiding arrest for corruption, despite occasional protestations that she plans to return. The disqualification of Mr Sharif “seems to have no legal basis at all”, declared a team of European Union election observers in an internal document that was leaked to the press. The law keeping Ms Bhutto out of the race is “widely seen as person-specific”. With no star campaigners, the election has been a tepid affair by South Asian standards. The headquarters of Ms Bhutto's Pakistan People's Party in Islamabad, the capital, has all the bustle of a library.

The parties of the absentee prime ministers say the election is being rigged against them. “Pre-poll rigging” takes many forms, they say: the government weans candidates away from them, sometimes by threatening to arrange corruption charges against them; mobilises the administration to work for friendly candidates; and has redrawn constituencies to favour those candidates—all charges the government denies. The main beneficiary is said to be a party that broke away from the Pakistan Muslim League of Mr Sharif, called the PML (Q) but known to its adversaries as the “king's party”. There are others in the race,

however, including dozens of independents, thought to be also aligned with the government.

The commonest forecast is for a hung parliament with PML (Q) as the largest party, a result that would suit General Musharraf; but other outcomes are possible. Some think there will be enough rigging to hand PML (Q) plus other presidential allies an outright majority, allowing them to lock the two mainstream parties out of government. A poll by the BBC's Urdu service predicts a majority for Ms Bhutto's Pakistan People's Party (PPP), a result that would no doubt discomfit General Musharraf. The Muttahida Majlis-i-Amal (MMA), an alliance of half a dozen Islamist parties that have never before joined forces, might also do well.

The election, in other words, may well mark the beginning of a new power struggle. Because of politicians' past misbehaviour Pakistan was “almost becoming a failed state” when he took over, says General Musharraf. It is safe to let them back into office mainly because of two constitutional changes he introduced—the power of the president to dismiss parliament, and the establishment of a National Security Council (NSC). This body will be composed mainly of civilians, including the prime minister, the leader of the opposition and chief ministers of the four provinces, but the real clout, many fear, will belong to its military members: the president, and four other top generals.

This should not worry politicians, says General Musharraf. The prime minister will have “total freedom to do anything he likes with governance,” he insists. The NSC is merely a “consultative” forum. But it looks as though it is going to be a busybody. The parliament can re-amend the constitution, but the NSC “will make sure no personal agendas are being followed,” says the president. If the prime minister's policies are wrecking the economy, the NSC “will ask him what he's doing”. The idea is that by giving the armed forces a constitutional role in democracy it will never again have to suspend democracy as it has done so many times in Pakistan's past. The government touts other constitutional novelties, such as the introduction of seats reserved for women.

The PPP and the Muslim League have made opposition to the president's amendments the centrepiece of their campaigns. The MMA objects to them only slightly less fiercely than it does to Pakistan's alliance with America in the war against terror. General Musharraf will get less flak from the PML (Q) and those like it—but even seemingly compliant Pakistani prime ministers have a history of bucking the military yoke once in office.

What happens after the election depends on how much rigging appears to have taken place (the EU team will render a verdict on October 12th), on the line-up of seats in parliament and on the calculations of the parties, which will be weighing up principle against advantage. General Musharraf seems more determined than earlier military rulers to armour his amendments against parliamentary tampering, says Hamid Khan, president of the Supreme Court Bar Association. He might try to do this by insisting that incoming MPs take their oaths of office under the “legal framework order” that gives the amendments force and secures his position as president. Opposition politicians might well refuse. “So the crisis will arrive very soon,” says Mr Khan. The EU observers say they fear that the anger of Ms Bhutto's supporters could cause unrest.

But the mainstream parties have a pragmatic streak. Many reckon the PPP and the Muslim League are angling for a deal with the president. “We are open for dialogue,” says Raza Rabbani, acting secretary-general of the PPP, though he rules out compromise on the constitution. It is even possible that the NSC will work, though it is hard to imagine any prime minister submitting his policies for second-guessing by not only the armed forces but also the opposition. The new prime minister may not cross swords with General Musharraf for months, or even years. But the odds are that, in the end, he will. The familiar ructions of Pakistani politics will resume.

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China

The case of the poisoned ducks

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Even villagers can challenge authority

WHEN 2,000 ducks died suddenly in a village on the northern outskirts of Beijing, Wang Canfa, a lawyer, satisfied a local court that pollution from an industrial-scale pig farm was to blame. Noxious sodium hydroxide had been discharged illegally into the Huai River. A judge awarded seven village households a total of 90,000 yuan ($10,880) in damages. But the pig farm, one of the area's largest enterprises, was affiliated to the local government and saw no need to pay. Mr Wang, a professor of environmental law and founder of the Centre for Legal Assistance to Pollution Victims in Beijing, went back to court on behalf of the duck farmer with the single largest claim and secured it. But Mr Wang is especially pleased that the other duck farmers in the village then successfully pursued their claims in the courts on their own.

Chinese citizens have had the right to claim damages from polluters since an environmental-protection act was passed in 1979, and have been doing so in growing numbers: in 1999 there were more than 252,000 cases. But not all claims turn out as satisfactorily as in the duck case. A tree farmer named Han Xiang had been successfully growing fruit and pine nuts in Inner Mongolia for 14 years until 1999 when a copper smelter opened nearby. Mr Han claimed that sulphur dioxide from the smelter caused acid rain that in turn killed his trees, worth the equivalent of $170,000. The local authority, the owner of the smelter, offered him less than $17,000, which Mr Han rejected. A court turned down his claim, and a series of appeals that dragged on for two years eventually ended in failure.

Mr Han's story showed flaws in the Chinese legal and regulatory system that will need to be corrected before citizens can count on getting the protection the law is meant to provide. One problem is that China's courts are even worse-prepared than their western counterparts to evaluate the complex technical information on which pollution cases typically hinge. Another is the courts' fuzzy rules on the admissibility of expert evidence, a difficulty made worse by their lack of independence. In Mr Han's case, the investigators chosen by the court seemed to lean heavily in favour of the smelter, and actually included one of the smelter's managers.

A local-government witness described the smelter as a key “takeoff enterprise” that would provide jobs and tax revenues. This had little bearing on the facts of the claim, but fed the impression that the case was fixed from the start. Mr Wang suggests the use of juries in such cases. “Judges rely on the local government for their appointments and for the financing of their courts. Any judge knows that if he rules against the government's interests, he may not be a judge for much longer.”

In addition to representing beleaguered clients, Mr Wang's centre trains lawyers to handle environmental cases. It is a sign of his optimism that he is now preparing to train judges too. He says the readiness of judges to accept such training points to a genuine desire in official circles to improve the system.

There are other signs, too. More than 2,000 environmental NGOs are now registered in China. Though few are truly free of official links, they help to educate people about the environment, and about their legal rights. The authorities are especially keen for NGOs to do more work in rural areas; at present about 90% operate in cities and prosperous areas near the coast.

Still, China remains a place where individuals' rights are easily stifled by the authorities' overbearing regulations. When your correspondent sought permission in the city of Tangshan for a meeting with someone about a pollution claim against a coking plant, he ended up spending an hour with the police instead, before being asked to leave town. Free though they are to press their claims in court, pollution-weary citizens cannot talk to journalists without permission.

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The Asian Games

The Koreas united, for a day

Oct 3rd 2002
From The Economist print edition

Plus Afghanistan's sporting comeback

EPA

Blue is the colour

THERE has been no shortage of excitement in the 14th Asian Games, which opened in the South Korean city of Busan on September 29th. Forget the usual dancers, fanfare and fireworks that feature in these events. It was the teams from North and South Korea marching together at the opening ceremony under one flag—which pictures a blue united Korean peninsula on a white background—that stole the show. Thereafter though, the two teams stuck to their own flag.

This is the first time North Korea has taken part in an international sports event hosted by the South, and 300 or so North Korean athletes and officials turned up with an entourage of over 350 musicians, supporters and reporters. The event is also a first for East Timor, the youngest country in the games (the biggest ever with close to 10,000 participants from 44 countries). And the competition, which will last for two weeks, is marking the return of Afghanistan into international sport.

No Afghan team has been seen in an international competition since 1994. Decades of war destroyed many sporting stadiums and pushed athletes into exile or combat. The Taliban believed most sporting activities to be un-Islamic. Those stadiums that survived were the settings for public executions. Most countries banned Afghan athletes from competitions anyway.

Women disappeared from the sporting scene. The men who took part in the few sports still allowed had to do so in long sleeves and trousers. Boxing was eventually authorised, but—until the Taliban changed their mind in 1998—without punches to the head. Even in Pakistan, one of the few countries to recognise the regime, Afghan athletes had to withdraw from a boxing tournament, since international rules do not allow boxers to wear beards.

So the fact that Afghanistan has sent a team of 44 athletes, including four women, to the games is an achievement in itself. Besides footballers, there are boxers, wrestlers, and even a cyclist. But a comeback is not easy. “We have been in the football wilderness for 20 years,” says Abdul Alim Kohistani, president of the country's football association. Kabul's main stadium is in poor condition, and only half the pitch can be used. The team could make the trip only because of a donation from FIFA, football's international ruling body. So Afghanistan's defeats, 10-0 against Iran and 11-0 against Qatar, came as no surprise.

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Uzbekistan

The European Bank for Repression and Dictatorship?

Oct 3rd 2002
From The Economist print edition

Human-rights groups don't like the EBRD throwing jollies in Tashkent

WHAT on earth can the European Bank for Reconstruction and Development have been thinking of? A big campaign by many of Europe's and America's human-rights outfits is now under way to make the EBRD think again about holding its annual meeting next year in, of all places, Tashkent, the joyless capital of Uzbekistan. Playing host to a gathering of this type is a feather in the cap of Islam Karimov, Uzbekistan's dictator since its birth in 1991, but it is turning into an embarrassment for the bank.

The EBRD is not, it is true, primarily a political organisation, its goal being to extend soft loans to the post-communist countries of Central and Eastern Europe, including the former republics of the Soviet Union. Still, as Human Rights Watch points out, its charter's Article 1 defines its task as being the promotion of market economies and private business in “countries committed to and applying the principles of multi-party democracy, pluralism and market economics”. Uzbekistan might conceivably be said to pass the third test, but is about as far as Iraq towards satisfying the other two.

Don't take the activists' word for it. The American State Department reported this year that Uzbekistan's “human-rights record remained very poor, and it continued to commit numerous serious abuses. Citizens cannot exercise the right to change their government peacefully; the government does not permit the existence of opposition parties. The government severely restricts freedom of speech and the press, and an atmosphere of repression stifles public criticism of the government”.

The use of torture, it also found, is common: “Police and the National Security Service routinely tortured, beat and otherwise mistreated detainees to obtain confessions, which they then used to incriminate the detainees. Police also used suffocation, electric shock, rape and other sexual abuse.” Uzbekistan, most analysts would agree, is one of the world's most repressive states, with thousands of political prisoners and little sign of improvement. The EBRD's president, Jean Lemierre, counters that the holding of the meeting is not an endorsement of Uzbekistan's policies, but rather an incentive for the country's authorities to make good on their promises of reform. The human-rights people say the meeting ought to be made conditional on such progress.

Uzbekistan has become a useful ally in the fight against terror, and has lent military facilities to America for its Afghan operations. The war on terror is making awkward bedfellows, as war always does. But that does not add up to a reason for a body whose job is meant to be the promotion of western values to cosy up to people like Mr Karimov. Fortunately, there is still time for second thoughts.

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The Philippines

It's war

Oct 3rd 2002 | MANILA
From The Economist print edition

Getting people to pay their taxes is the government's biggest challenge

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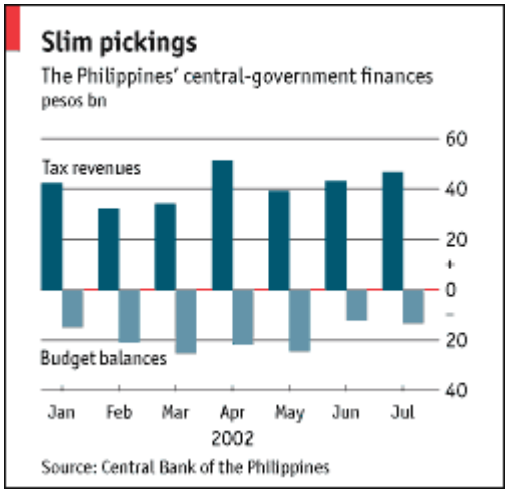

FILIPINO ministers jokingly refer to Gloria Macapagal Arroyo, the president, as the economist-in-chief. The joke took on new resonance earlier this year when she ordered all her forces into battle against the Philippines' pervasive tax evasion. To show how serious she is, she even hauled a manacled prisoner of the war against tax cheats in front of the cameras, for a personal dressing-down on television.

The president's belligerence is understandable. Morgan Stanley, an investment bank, recently estimated tax evasion at almost $8 billion each year. By the government's own reckoning, businesses dodge over 40% of the VAT they owe. Government revenue in general, which reached a peak of 19.4% of GDP in 1997, has since fallen to 15.5%—as compared with 20% in neighbouring Malaysia.

The result is an alarming increase in the budget deficit. It has already breached this year's target of 130 billion pesos ($2.5 billion), and might reach as high as 170 billion. Next year's target has been raised from 98 billion pesos to 142 billion. No wonder, then, that the interest paid on Filipino government bonds is rising as the country's finances deteriorate. Jose Camacho, the finance minister, and other economic grandees are currently on a world tour to reassure twitchy investors.

Mr Camacho has regaled them with a number of plausible reasons why revenue fell short of expectations during the first half of the year. Low inflation meant that the nominal value of receipts was less than projected; cheap money hit the tax on interest, and the strong peso cut into the value of import taxes. The two healthiest sectors of the economy—agriculture and exports—are both lightly taxed.

But blatant tax-dodging remains the explanation for most of the shortfall. In the first half of the year, the volume of alcohol sold jumped some 30%, but the revenue from the excise tax on alcohol increased by just 2%. Similarly, revenue from corporate income tax fell 8%, even as corporate incomes rose.

Naturally, Mr Camacho has a battle plan on this front as well. The Bureau of Internal Revenue (BIR), the main tax-collection agency, has come up with all sorts of methods to catch VAT cheats. It will set payment benchmarks for different types of business, and then investigate those that fall short. It also plans to match up the VAT receipts of suppliers and purchasers, to make sure they are both declaring the same amounts.

In the longer term, the government hopes to persuade Congress to tax cigarettes and alcohol on their value, rather than a fixed sum per unit sold. It is also pushing a plan to “corporatise” the BIR, insulating appointments from political interference and stripping its employees of their status as civil servants. That would make it easier to fire the bureau's many crooks and reward the hard workers.

But no government incentive is likely to rival the bribes offered by would-be cheats. Nor do the tax dodgers show any willingness to surrender. In the past 30 years, they have ignored no fewer than 15 amnesties, confident that they will never get caught. Those that are can put up an endless fight in the Philippines' murky courts. The family of former strongman Ferdinand Marcos, for example, still has not paid its arrears, despite a supposedly final ruling in 1999. The BIR offers deep discounts to tax dodgers

who do not challenge their assessments in court—more of a retreat than an offensive.

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The Philippines' presidency

Men and women in black

Oct 3rd 2002
From The Economist print edition

Saving the Philippines from the scum of the universe

Reuters

Gloria gets tough

Get article background

THE only thing harder than defeating an alien invasion, it seems, is pleasing the chattering classes of Manila. So Gloria Arroyo, the president of the Philippines, learned last month when she and four economics ministers modelled for the *Philippine Tatler* in black suits and dark glasses, in a parody of the monster-smiting heroes of “Men in Black”, a Hollywood comedy. Bristling citizens and indignant pundits quickly denounced the affront to the country's highest office. The president, her press secretary retorted, was just having fun.

Mrs Arroyo has been having a lot of that sort of fun lately. She regularly summons television crews to the presidential palace to film her upbraiding captured kidnappers, or computer hackers, or tax dodgers. If the police kill a crook, she flies to the scene of the shoot-out to pose over the bleeding corpse. Her speeches are peppered with lines worthy of “Dirty Harry”.

This sort of machismo is common enough among many Filipino politicians, but was not previously practised by Mrs Arroyo, a former academic and civil servant. She used to pride herself on the difference between her sober technocratic style and the high-living, hard-drinking ways of her playboy predecessor, Joseph Estrada. Under Mr Estrada, a former matinee idol with a rakish moustache and a winning grin, Filipino politics began to resemble the sort of swashbuckling movie he used to star in: plenty of drama and injustice, culminating in an almighty dust-up (in the form of the popular protests that toppled him). Amid all this, the budget deficit ballooned and legislation stalled.

Mrs Arroyo, on other hand, started off on a dull but worthy tack, with schemes to rein in spending, reform tax collection and overhaul power provision. Alex Magno, a political commentator and occasional speechwriter for the president, argues that her new persona represents a serious attempt to outflank her political rivals. “Her first thought when she gets out of bed in the morning”, he says, “is how to win over Estrada's supporters.” With good reason: her likeliest opponent in the election of 2004 is Panfilo Lacson, a former policeman with a genuine tough-guy image.

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Turkey and the Iraqi Kurds

Allies from hell

Oct 3rd 2002 | ANKARA
From The Economist print edition

Corbis

While the Kurds look to semi-independence in a post-Saddam Iraq, some Turks are looking back to Ottoman dominion with nostalgia

AS THE American administration accelerates its efforts to drum up international support to unseat Saddam Hussein, it faces open dissent from two of its most prized, and most mutually hostile, allies: Turkey and the Iraqi Kurds. With tension growing between the two, American officials are trying to find a magic formula to satisfy their irreconcilable demands.

Turkey, declaring that it will not take part in any operation against Iraq that could result in the creation of an independent state for that country's 3.5m or so Kurds, has vowed to intervene militarily should the Iraqi Kurds make any move in that direction. No matter that the Kurds themselves say they understand that independence is not a realistic ambition. Turkey also says that it is equally opposed to the establishment of the federal zone within a united Iraq that the Iraqi Kurds insist is their right, and that they are demanding in exchange for their support for an American-led operation.

Turkey fears that a federal arrangement would lead to similar demands not just from its own 12m-odd Kurds, but also from Iran's 6m. It would, suggests a Turkish diplomat, “create an inextinguishable inferno of regional chaos and instability.”

Turkey has economic worries as well. Tariq Aziz, Iraq's deputy prime minister, was in Ankara this week. He reminded his Turkish hosts that, should war break out, Turkey's wobbly economy would be shaken by the loss of Iraqi business. Trade between the two has climbed back to its pre-Gulf war level of $1 billion a year.

The dilemma for America is that, in a war, help would be needed from both Turkey and the Kurds. Turkish bases are necessary for bombing raids, and the 50,000 fighters under Iraqi-Kurdish control would be useful in overthrowing Mr Hussein. And if American troops were to be deployed in Kurdish territory, they would need to come through Turkey.

The Iraqi Kurds are adamant that Turkish forces themselves should not take part in any operation, if for no other reason than that the presence of Turks would invite Iranian intervention. They are even threatening, as a last resort, to cut a deal with Mr Hussein should the Americans ignore their demands. Taha Yassin Ramadan, Iraq's deputy president, told a visiting group of Turkish journalists last month that the Iraqi people would fight alongside “our Kurdish brothers” to keep Turkish forces out of their country.

Mr Ramadan was responding to a claim, made last month by Turkey's defence minister, Sabahattin Cakmakoglu, that Kirkuk, Iraq's main oil-producing region and an erstwhile part of the Ottoman empire, was historically part of Turkey. Kirkuk, which is now under Baghdad's control, is intended by Massoud Barzani and Jalal Talabani, the two Kurdish leaders who have been running northern Iraq since the end of the Gulf war, to be the capital of their proposed federal state. Kirkuk, declared Mr Barzani, could become “a graveyard for Turkish troops just as it had been for Ottoman forces”.

Mr Barzani and Mr Talabani are old enemies. But this week they came together to agree on a new draft constitution for their envisaged “zone”, and the Kurdish regional parliament is due to reconvene on October 4th for the first time since 1994. This new-found unity is deeply disturbing to the Kurds' regional foes—Iraq, Turkey and Iran—which for decades backed one Kurdish faction against the other to keep the Kurds weak and divided.

Indeed, not so long ago, the Turks and Mr Barzani, whose Kurdistan Democratic Party controls Iraq's 700km (450-mile) border with Turkey, were the best of friends. Aided by Mr Barzani's fighters, Turkish troops would wade into northern Iraq to hunt down separatist Turkish Kurd rebels in their mountain hideouts.

In exchange, Turkey allowed its truck drivers to smuggle in lots of Iraqi diesel on which Mr Barzani's group would levy taxes. Revenue from this illicit trade (to which America turned a blind eye) helped finance the construction of hundreds of new schools, roads and hospitals in KDP-held territory, as well as a fledgling Kurdish army and local police force.

But once Turkey had captured Abdullah Ocalan, the Kurdish rebel chief, in 1999 and he had called off his 15-year insurgency, Mr Barzani ceased to be useful. Instead, he came to be perceived as a threat, not least because he began mending fences with Mr Ocalan's group. In a bid to curb the KDP's influence Turkey banned the flow of Iraqi oil. It has also been courting Mr Talabani, while arming and training militia drawn from an ethnic Turkic minority known as the the Turcomens, which is based in Mr Barzani's territory.

The Iraqi Kurds are misguided, say Turkish officials, in thinking that their support is as important to America as Turkey's. “If the Kurds are naive enough to believe that they are in the same league as Turkey, that only proves that they have not learnt from history,” says one stern official.

The Iraqi Kurds have not forgotten a rather more recent bit of history. Memories of how America failed to protect them from Iraq's army after encouraging them to rebel against Mr Hussein at the end of the Gulf war is etched in their minds. This, their leaders say, is precisely why they want watertight guarantees of protection in return for their support. And these guarantees, says Safeen Dizayee, a prominent KDP official, “include protection not just against Iraq but against all foreign forces that would destabilise the region.”

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Iran and Europe

Friends in need

Oct 3rd 2002 | TEHRAN
From The Economist print edition

Muhammad Khatami's popularity abroad is appreciated, even by his foes

EUROPEAN UNION delegates, investigating Iran's dismal human-rights record, were treated to decorous prevarication in Tehran this week. In return for easing Iran's international isolation, the EU wants it to treat its citizens better; a moratorium on the stoning to death of adulteresses would be a start. But the trade and co-operation agreement that the EU is offering as an incentive also requires Iran to go through economic hoops, and here its would-be reforming president, Muhammad Khatami, is doing rather better.

Iran's economic liberalisation has been long delayed by fears that this would lead to renewed thraldom to the foreign powers that dominated the country for most of the 20th century. But Mr Khatami has set himself the task of ending Iran's pariah status, and, as he realised pretty soon commercial relations can put pep into political ones.

Last week a law came into force that protects foreign investors by spelling out their right to own companies based in Iran, thus dispelling ambiguities about the repatriation of capital and profits. Foreign executives will pay tax worth 25% of their salaries, rather than the swingeing 84% of old. Inward investment remains pathetically low, but this is at least a start.

Yet, as the new law makes implicitly clear, disputes between foreign investors and their local partners must be settled by Iranian judges. To get round this, Iran is negotiating custom-made bilateral treaties that provide for international arbitration. Mr Khatami may sign such a treaty when he is due to visit Spain later this month.

If he does, his conservative opponents will no doubt accuse him of selling Iranian companies short. Fighting current trends the conservative judiciary is also threatening to prosecute a state-run polling institute that found a large majority of Iranians in favour of starting talks with America.

Yet there is irony to the attitude of senior conservatives. Although they resent the president's actions, they are banking on Mr Khatami's foreign friends to help Iran escape international peril. In the American-Iraqi confrontation, Iran's task, they believe, is to avoid behaviour that would provoke George Bush into putting Iran and “regime change” into the same sentence.

Mr Khatami alone can plot such a course. Next week, he will learn from the British foreign secretary, who is due to visit Tehran, what is expected of him. All of which gives Iran's president unusual punch in threatening to resign unless the conservative institutions ranged against him relinquish some of their authority. Many conservatives would like to call the president's bluff, but fear the consequences. Mr Khatami, with the help of his European friends, is not ill-armed.

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Côte d'Ivoire's civil war

The melting-pot cracks

Oct 3rd 2002 | ABIDJAN
From The Economist print edition

A war that threatens all the neighbours

Get article background

EPA

But who are these rebels?

WHEN state television urged all patriotic Ivorians to wear the national colours, orange, white and green, and to drape their cars with the national flag, the country's 5m foreigners, who make up roughly a quarter of the population, knew they were in trouble. Since the attempted coup on September 19th, blamed by the government on Côte d'Ivoire's neighbours, the country has been tottering on the brink of full-scale civil war. Hundreds of people have died, thousands have fled, and foreigners are in particular peril.

On October 1st, the rebels, who call themselves the Patriotic Movement of Côte d'Ivoire, captured another northern town, consolidating their apparent control of much of the north of the country. In Abidjan, the commercial capital on the south coast, tens of thousands of Ivorians marched through the streets, waving flags and chanting nationalist slogans. Newspapers accuse foreigners of collaborating with the rebels, and the embassies of France and Burkina Faso have been attacked by mobs.

The police round up young men from Ghana, Nigeria, Liberia, Sierra Leone and Mali, load them on to trucks and take them who knows where. Many are hiding. One African diplomat mentions that there are 600 of his country folk holed up in a nearby garage. A new telephone number that Ivorians can call to denounce “terrorists” is being abused, according to a human-rights activist. “It's worse than during military rule,” he says, “people disappear, and are being killed in their dozens.”

Côte d'Ivoire was not always so bigoted. Félix Houphouët-Boigny, the relatively benign dictator who ruled until 1993, insisted that immigrants from other African countries were brothers, and welcomed the hordes who came to grow cocoa, open shops and generally take advantage of his country's prosperity. Mr Houphouët-Boigny allowed foreigners to hold dual nationalities, and they repaid him with their support.

His successors, however, have tried to rally followers by appealing to national and tribal prejudices. The first, Henri Konan Bedié, announced a policy of “*Ivoirité*”, seeking to reserve land ownership for Ivorians and to bar foreigners from voting. The current regime is even more parochial. Laurent Gbagbo, the president, has written a book praising his own tribe. His home-affairs minister, who was killed in the mutiny, introduced new identity cards that cost West African foreigners 15 times as much as locals, (and other foreigners 300 times as much). This led to many residents losing their right to vote.

Recent elections were marred by ethnic violence, not only against foreigners, but between Ivorians from the mainly Muslim north and the Christian and pagan south. Last year, before the UN conference on racism, the president of Senegal complained that a Burkinabe in Côte d'Ivoire can expect worse treatment than a black man in Europe. Ivorian crowds, incensed at the suggestion that they were xenophobic, responded by trashing Senegalese shops and roughing up their owners.

Things have grown dramatically worse since last month's revolt. The government says the rebels are a mixture of mutinous soldiers, northerners, and mercenaries from neighbouring countries such as Burkina, Liberia and Sierra Leone. This may be true, although it is far from clear. Two weeks after it all began, the rebels still have no obvious leader or motive, besides a stated desire to topple Mr Gbagbo, and to end

domination by southern Christians.

But such uncertainty affords foreigners and northerners no protection. Diana Mason, a Liberian living in a slum of Abidjan, describes how the gendarmes came to “clean” the place up. This involved robbing her and her family at gunpoint. Then a mob of youths burned down their shack, while her Ivorian neighbours egged them on. In the centre of town, a taxi-driver watches policemen confiscate a colleague's car, and sneers that the man deserved it, for being a northerner.

The region quakes

Côte d'Ivoire's neighbours are horribly worried. The presidents of South Africa and Nigeria, Africa's two biggest heavyweights, rushed to attend an emergency summit in next-door Ghana. Six West African foreign ministers flew into Abidjan to try to mediate between the government and the rebels. They were due to meet rebel representatives on October 3rd. Some 2,500 troops representing ECOWAS, an organisation of 15 West African states, were on standby to support the government if the mediation talks should fail. France promised logistical support.

Côte d'Ivoire is the richest country in West Africa, and has the fourth-largest economy south of the Sahara. Until three years ago, when it suffered its first coup, it was a rock of stability in a region lacerated by war. If it were to become even a fraction as chaotic as, say, Liberia, the repercussions would be dire. Nearby countries rely on remittances from migrant workers in Côte d'Ivoire. If these people were to have to return home in a hurry, all the countries roundabout would suffer, and Burkina and Mali would be devastated.

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Mozambique's ten years of peace

Booming, if a little bit dirty

Oct 3rd 2002 | MAPUTO
From The Economist print edition

Joaquim Chissano has done well but his successor must tackle corruption

TEN years ago, Mozambique's government signed an accord with the Renamo rebel group, ending 16 years of war. Since then the country has enjoyed a textbook recovery. The fighting stopped; UN soldiers collected the guns; some 5m displaced people went home; land once sown with mines was sown with maize instead; and two, mostly tranquil, general elections were held in 1994 and 1999.

Peace, and the government's decision to dump Marxism, have allowed the economy to boom. Growth last year hit 14%, driven by dewy-eyed donors and profit-hungry private investors. A big aluminium smelter, a new toll-road to South Africa and a planned gas pipeline are all visible evidence that, as the foreign minister says: “we are on the right path.”

After the war, the country was in ruins. Many Mozambicans survived on emergency aid, on pickings from the bush and by begging. But peace has brought roads, bridges, schools and telephone lines. Life expectancy, literacy and school enrolment rates have risen from desperate to merely bad. The UN says that between 1994 and 2001 the average Mozambican doubled his annual buying power from $617 to $1,050, and could expect to live for an extra three years, to the ripe old age of 45.

The icing on the cake is that the president, Joaquim Chissano, who took over in 1986, is to step down at the next election. Unlike some of his neighbours, Mr Chissano says he thinks that 18 years in office will be long enough for one man. But he is not happy about his likely successor. In June the ruling party, Frelimo, picked a tycoon named Armando Guebuza as its candidate for 2004. Mr Chissano wanted a younger minister, but was unable to persuade his party.

Mr Guebuza faces two big challenges. Northerners grumble that the south gained most from peace, pointing out that the capital city alone accounts for a third of national income. Donor money sloshes around Maputo: its restaurants are packed with prawn-chomping aid workers.

Whereas Mr Chissano is at least married to a northerner, Mr Guebuza is hated in the north for his part in deporting thousands of northern migrants from Maputo. Renamo, the old rebel group, has reinvented itself as a political party, and dominates the north. If Mr Guebuza is to win votes outside his home region, he will have to address northern gripes.

The other challenge is Russian-style gangsterism. Since ditching Marxism, the once-frugal Frelimo elite is rushing to get rich. Mobsters, smugglers and money-launderers are thriving. Graft is endemic: even nurses demand bribes before applying bandages.

A banking scandal, which came to light five years ago and almost certainly involved senior politicians, seems to have prompted murders and a cover-up. Prosecutors investigating it were dismissed for alleged corruption. A state lawyer who tried to prosecute the prosecutors was shot several times, but survived. Last year, the top banking regulator was murdered while investigating the case.

Two years ago, an investigative journalist, Carlos Cardoso, was assassinated after exposing links between crooks and politicians. Six men were arrested for his murder, but the chief suspect was apparently allowed to escape last month. A criminal investigator had given warning, in June, that such an escape was imminent, but he was removed from his duties, and someone then threatened to kidnap his son.

None of this reassures donors or investors. Mr Guebuza promises to clean things up, but is a tycoon with long links to the ruling party the right man for the job?

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Germany's government

A chancellor looks anxiously ahead

Oct 3rd 2002 | BERLIN
From The Economist print edition

AP

For the re-elected Gerhard Schröder, the going is already getting even tougher

DURING his successful re-election campaign, Chancellor Gerhard Schröder made it plain. Read his lips: he would not put up taxes. To do so in the global gloom, he declared, would be “economically absurd”. Yet no sooner was his coalition of Social Democrats and Greens back in power than the first calls for tax rises began to be voiced. Bring back wealth and inheritance taxes, the Social Democrats' regional leaders urged. Slap another five cents on every cigarette, the health minister chimed in. Re-introduce a capital-gains tax on the sale of cross-shareholdings in companies. Extend the “green tax” on fossil fuels, certain Greens pleaded. For a moment, it looked as if the chancellor would bend before this mounting pressure and break a key election promise. But after a first round of talks between the coalition partners the chancellor has reaffirmed his message. He says there will be no tax increases this year—or next.

But the pressure remains. The country's finances are parlous. Tax revenue, which had been projected to rise by 2% this year, fell by 4% in the first eight months compared with the same period last year. Rising unemployment is pushing up state spending on welfare. Regional as well as federal coffers are empty. The government says it no longer expects Germany's economy to grow by more than 0.5% this year or 1.5% next, compared with its previous forecast of 0.75% and 2.5% respectively. Figures out this week show a new hole of *euro*10 billion ($10 billion) in this year's budget; a similar one is forecast for next year. If these are not plugged, Germany's public deficit, already close to the EU euro-zone's permitted limit of 3%, will probably widen far beyond that mark. Yet the new government, due to be formally installed later this month, is still committed to eliminating the deficit altogether by 2006 at the latest.

Raising taxes might have seemed the easiest way out. It is what the trade unions as well as many Social Democrats and Greens want. But business leaders and most economists are dead against. So, too, is Hans Eichel, Mr Schröder's finance minister, who has turned his bid to balance Germany's books for the first time since 1970 into a personal crusade. Indeed, he hinted that he might resign if his new austerity programme were not accepted. For the moment, he appears to have his boss's backing. This week, the seven Social Democrats and seven Greens delegated to draw up a new government contract agreed to find the required extra savings by ending tax breaks and subsidies and by cutting spending, not by putting up taxes.

But a rebellion is brewing among Social Democratic leaders in the regions. The day after Mr Schröder's categorical *Nein* to tax hikes, Wolfgang Clement, the powerful premier of North Rhine-Westphalia, the most populous of Germany's 16 *Länder* (states), announced that he was ready to introduce a bill in the

Bundesrat, the parliamentary chamber where the states are represented, to bring in a new wealth tax. The proceeds, which would go exclusively to the *Länder*, could be earmarked for education, primarily a *Land* responsibility. Germans were shocked by last year's OECD study of the educational performance of 15-year-olds in 31 countries which put their country in a lowly 21st place. Mr Clement thinks he could get enough support in the conservative-controlled Bundesrat to get approval for the measure. Mr Schröder could do little about it. The bill would not require approval by the Bundestag, the lower house.

No decisions have yet been taken on where the proposed spending cuts should fall. But there is ominous talk of a need to review defence spending, prompting fears that the government might try to wriggle out of its commitment to buy 73 Airbus A400M military transport aircraft. In the past decade, German defence spending has already shrunk fast and now accounts for only 1.5% of GDP, half its level at the cold war's end. The Americans, who devote 2.9% of their GDP to defence, have long urged their European allies, particularly Germany, to shoulder a bigger share.

Yet Mr Schröder is clearly eager to improve Germany's relations with the United States after the severe strains caused by his strident vote-catching rejection of German participation in any American-led attack on Iraq. There has even been talk of a meeting between Mr Schröder and President George Bush, who have not spoken since last June, before the NATO summit in Prague at the end of next month. Some Americans, the Germans note, have begun to make conciliatory noises. Mr Bush sent his best wishes on Germany's Unity Day, October 3rd. Colin Powell, the secretary of state, described Germany last week as “one of our closest friends”, adding that he expected their already strong relationship “to grow and flourish”. Other Americans, however, are less sanguine. Richard Perle, an influential Pentagon adviser, said the best way to mend relations would be for Mr Schröder to resign.

One notable resignation has indeed occurred, with Dieter Kastrup's stepping down from the post of security adviser to the chancellor. Officials say that, at 65, he was due to retire anyway. But this was not on the cards when he started his job at the beginning of the year. In any event, many German diplomats have been uneasy about the collision course steered by Mr Schröder over Iraq during the campaign. Meanwhile, Gunter Pleuger, Germany's most senior diplomat, has been appointed to Mr Kastrup's previous job as ambassador to the UN. From January 1st for two years, Germany will have a (non-permanent) seat on the UN's Security Council, where its voice will be heard on Iraq.

Berlin is awash with rumours of other moves, on the domestic front. Mr Schröder says he will not shuffle his cabinet dramatically but some changes will have to be made. Three ministers—for justice, family affairs and the arts—have resigned. Peter Hartz, the Volkswagen man who chaired the government's commission earlier this year on labour-market reform, was tipped to succeed the lacklustre Werner Müller as economics minister but has apparently rejected the idea. He might, however, be tempted if offered a new “super-ministry” for economics and employment. But Mr Schröder seems intent on keeping his much-criticised employment minister, Walter Riester, a former union leader, at least for the moment.

Mr Riester is expected to play the main part in pushing through Mr Hartz's proposals, which Mr Schröder has promised to implement in their entirety. The unions, which gave them broad backing before the election, are now—predictably—raising objections to many of the central recommendations, including the creation of a low-wage sector, the reduction of job security for older job-seekers, and the relaxation of rules for temporary work and short-term contracts. The conservatives say they will oppose many of the proposals. Some of the government's own backbenchers may resist them too.

So the new government looks set to face painful early challenges. Mr Schröder has so far been making the right brave noises. “There is no time to lose,” he says. “If there is any opposition, it will be broken”. The country is holding its breath.

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Spain and its Basques

Independence? Let's have a vote

Oct 3rd 2002 | MADRID
From The Economist print edition

The region's separatist government talks of a referendum

Reuters

Ibarretxe flutters with his flag

HERE'S an idea: let Spain's Basque region redefine its relationship with the central state in a “free association” under a shared sovereign. So the region's Basque Nationalist Party (PNV) premier, Juan Jose Ibarretxe, has now proposed—and a daft idea it is, says Spain's prime minister, Jose Maria Aznar: the deluded ranting of “a fanatic” which “runs absolutely counter to the constitution and jeopardises the achievements of the past 25 years.”

But Spain's constitution of 1978 and the special statute defining the extent of Basque autonomy are not static documents, argues Mr Ibarretxe. The region already has wide legislative and executive powers, notably in tax-raising. On September 27th he set out his vision of it as an independent country, with its own citizenship and foreign policy, linked to Spain as an equal and operating as its associate within the European Union. On top, Spain's Navarre region, which some Basques think part of their homeland, should be allowed, if it chose, to join the new state, which would also seek special relations with three (supposedly) Basque provinces in south-western France.

Mr Ibarretxe said the plan would be fleshed out over the next year, and then put to the region's voters—but only in “peaceful conditions”. This has led to speculation that ETA, the Basque-separatist terror group, may be planning a ceasefire. It called one in 1998, after agreeing with the PNV that both would work for independence. That ceasefire ended in late 1999 with no progress towards a lasting settlement. This time the PNV denies any contact with ETA, and the gunmen's political wing, Batasuna, has damned Mr Ibarretxe's plan. Even so, he hopes to draw the extremists in, presumably despite the present court-ordered suspension of Batasuna and its likely total ban.

Mr Ibarretxe spoke of putting his plan to the government and parliament in Madrid for negotiation. Whether or not it gets that far, he said, the referendum would go ahead. The two main national parties, Mr Aznar's People's Party and the Socialists, have denounced the idea. But it got murmurs of approval from the Catalan nationalists, who run their own region, and those of Galicia, in Spain's north-west.

And the PNV has a dream: let King Juan Carlos help to arrange a deal. The PNV says it would accept the Spanish monarch as its sovereign, sharing that role with a powerful Basque president. That reflects the king's role in entrenching democracy in Spain in the years after the death of the dictator Francisco Franco in 1975. In public, the king has said only that he is committed to the constitution, which describes the country as indissoluble. In private, he may be the only person able to knock heads together in the gravest constitutional crisis Spain has faced since those days.

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The EU's agricultural policy

Reform? Forget it

Oct 3rd 2002 | BRUSSELS
From The Economist print edition

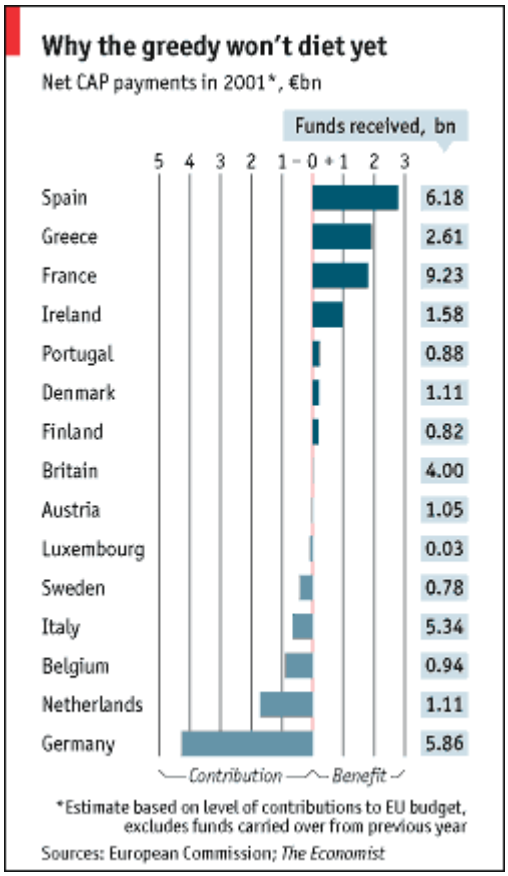
The latest plan to revamp Europe's farm policy looks stymied, for now

Get article background

FOR a few heady days in July, there was some reason to hope for reform of the European Union's notorious common agricultural policy. The EU lavishes around *euro*40 billion ($39 billion) a year on direct subsidies to European farmers. It is an expensive way to create surpluses, high food prices, environmental damage and harm to poor third-world farmers. In July, however, Franz Fischler, the EU's agriculture commissioner, proposed a shake-up.

He did not propose anything as radical as a cut in subsidies. But he did suggest redirecting the money, by "decoupling" it from production. Farmers would no longer be paid to over-produce. Instead, they would get flat payments, which would be progressively cut back, the money being redirected towards rural development.

"Would", alas, was the operative word. Ever since Mr Fischler unveiled his proposals, it has been clear that the big beneficiaries of the CAP would fight to prevent a reform that might cost them money. In mid-September farm ministers from six countries, plus the French-speaking bit of Belgium (a country now in such a state of disintegration that it no longer has a national farm minister), signed a letter, drafted by the French, defending the traditional form of the CAP. The letter was cast in airy generalities but its import was clear: forget about the Fischler reforms. The commissioner is understandably bitter, and has clashed publicly with Hervé Gaymard, the new French farm minister, who is close to President Jacques Chirac.



So is all hope gone for the Fischler package? Would-be reformers note hopefully that the French had wanted to get ten countries to sign their letter, but ended with only six and a half, Italy being the notable absentee. True, but even the six would be enough to form a blocking minority against the Fischler reforms.

Some countries in the reform camp, notably the Dutch, are determined to keep pressing. The Dutch government recently argued that if the CAP was not reformed before the EU admits ten new members in a couple of years' time, farm spending would swell by a further *euro*20 billion a year. This prospect also frightens the Germans and the British. But the signs are that they are preparing to beat a tactical retreat. They know they may not have the votes to push through the Fischler reforms; and they fear that if they insist on reform now, they may delay the EU's enlargement.

It looks as if the Germans in particular will agree to a French demand to delay major reforms until after 2006, in return for a commitment to some of the principles behind the Fischler package. One pro-reform diplomat says, just a bit forlornly: "People may not be ready to sign up to decoupling subsidies from production quite yet, but at least they are talking about it seriously—and that's a real advance." Wow.

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French winegrowers

Unpalatable message

Oct 3rd 2002 | MACON
From The Economist print edition

Why French winegrowers are glum

WHAT do you do if customers no longer want your product? Insult them, of course. Faced with the unpalatable prospect of destroying 10m litres of unsold Beaujolais wine—the equivalent of around 13m bottles—Maurice Large, president of the Beaujolais winegrowers' association, has accused modern wine-buyers of being “philistines”. On a recent trip to Australia he explained that “many new wine-drinkers are attracted to Australian or Argentine labels because they know no better than to treat wine like Coca-Cola.”

Australia's wine exports rose in volume by 21% last year and by 350% over the past decade. Beaujolais is not the only French region that is reeling. There were violent demonstrations in southern France earlier this year as winemakers took to the streets to protest against falling prices. Burgundy's winegrowers also staged furious protests at their annual meeting in July. Pierre-Henry Gagey of the Burgundy winemakers' association, striking a more realistic note, told local growers to improve their wines' quality. New World producers, he said, “make very good wine at very good prices.” He was heckled and booed for his candour.

In truth, the biggest decline in the consumption of French wine has come in France. Getting gently sozzled throughout the day has gone out of fashion. In the mid-1960s the average Frenchman drank a majestic 120 litres of wine a year; nowadays he soaks up fewer than 60.

But France's winegrowers have a clever solution too. Earlier this year their association sued the government over its campaign against drink driving. The growers claim that it is illegal under French law for safety campaigns to discriminate between products—such as those that make you drunk and those that don't.

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Italy's budget

Disappointing

Oct 3rd 2002 | ROME
From The Economist print edition

Silvio Berlusconi's latest budget proposals have so far pleased nobody

EVEN a brilliant salesman like Silvio Berlusconi, Italy's top tycoon turned prime minister, sometimes fails to convince the punters. The budget he has proposed for next year, approved by his right-wing government at the end of September, has disgruntled a swathe of Italians, from trade unionists to bosses. His recipe was not what they had been led to expect.

It amounts to a correction in the state's accounts of *euro*20 billion ($19.6 billion). Mr Berlusconi has proposed to chop spending by *euro*8 billion while hoping to boost revenues by *euro*8 billion with a kind of tax amnesty. He then hopes to gain another *euro*4 billion from the sale of state assets. This has allowed Mr Berlusconi and Giulio Tremonti, his economy minister, to make changes in personal income tax that will benefit the low-paid.

But they may be giving with one hand while taking with the other. Italy's local authorities will have to tighten their belts to bring their spending under a new limit. This will probably mean higher fares for local transport and higher charges for municipally run services like rubbish collection. Monthly payments to the many thousands of unemployed whom local authorities pay under the ruse that they are doing socially useful work are at risk. Public-sector recruitment will be frozen.

The big losers will be in the *Mezzogiorno*, Italy's poor south, where about a fifth of the people have no jobs. The handouts they had been expecting look likely to be withheld. The region still poses a massive headache for the government in Rome. Even if the cash had been available and Mr Berlusconi had wanted to be generous to the south, the secession-minded Northern League, on which his coalition depends, would have objected.

On October 1st, Carlo Azeglio Ciampi, Italy's president, called the gap between north and south “unacceptable”. Firms in the *Mezzogiorno*, he said, need a hand from the state. Indeed, the two big trade-union groupings that have signed a pact with Mr Berlusconi thought that it included more help for the south.

It is not just the workers and southerners who are sounding glum about the government's proposed budget. Antonio D'Amato, chairman of Confindustria, the employers' association, called it “a lot of shade and very little light.” As Mr Berlusconi has been discovering, keeping Italy's awkward accounts in order is proving a lot trickier than balancing the books of his television companies.

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Serbia's presidential election

Backwards or forwards?

Oct 3rd 2002 | BELGRADE
From The Economist print edition

Serbia's least acceptable face emerges as king-maker in its presidential race

THIS was supposed to be the presidential election that set Serbia firmly on the path to democratic reform and integration with Europe—either very swiftly or a bit more slowly, depending on which of the favourites prevailed. In fact, the first-round vote on September 29th left Serbia's political destiny largely dependent on a man of such extreme views that he has called Slobodan Milosevic, the despot who lost power two years ago, a traitor for capitulating to the West.

The new king-maker is Vojislav Seselj, head of the ultra-nationalist Radical Party. He did so well in last weekend's election, with 23% of the vote, twice as much as most pollsters expected, that his advice to supporters will be crucial in determining the outcome of Serbia's two-man run-off on October 13th.

On the face of things, Mr Seselj and his hotheads might be expected to prefer Vojislav Kostunica, the moderate nationalist law professor and current president of the Yugoslav federation, a post that will cease to exist when the federation is dissolved next year. Mr Kostunica topped Sunday's first-round poll with 31%. But as politicians of right, left and centre began horse-trading behind sealed doors, it was whispered that Mr Seselj might be tempted to strike a cynical bargain with Miroljub Labus, the economist and supporter of fast-track reform, who was runner-up in the first round with 28%.

How would such an odd deal work? Rather than tell their followers to vote for Mr Labus—a close ally of Zoran Djindjic, Serbia's pro-western prime minister—Mr Seselj's Radicals would be urged to boycott the second round. The run-off would then probably lack the necessary quorum of 50% of eligible voters, and the whole election would be void.

Why might such a deal tempt Mr Djindjic, who has won international favour (and alienated many of his compatriots, including Mr Kostunica) by helping to dispatch war-crime suspects, like Mr Milosevic, to the United Nations' war-crimes tribunal in The Hague?

Because if Mr Kostunica succeeded in his plan to shift his power base from the moribund Yugoslav federation to the Serbian republic, he would probably call a fresh election to Serbia's parliament in January—and Mr Djindjic might well be thrown out on his ear. The infighting between Belgrade's relative moderates is a sad contrast to the exultation that swept the city two years ago when Mr Milosevic was toppled in a popular uprising.

Belgrade's political mishmash is being watched closely in Podgorica, the unlovely capital of Montenegro, Serbia's little partner in the rump Yugoslav federation due to be replaced next year by a looser arrangement known simply as Serbia and Montenegro. In the run-up to a general election in Montenegro scheduled for October 20th, President Milo Djukanovic is campaigning for a total break with Serbia, even more final than the one foreseen under the current plan already approved by the European Union and other interested countries.

But he faces a stiff challenge from opponents keen to keep Montenegro in a federation with Serbia. Electoral stalemate in Serbia, however, could delay plans for the looser federation negotiated under strong pressure from Javier Solana, the EU's foreign-policy chief. At a minimum, that would make Montenegro's already tense politics a lot more fraught.

One of the few people with good reason to cheer Serbia's first-round vote is Mr Milosevic, whose trial in The Hague for war crimes is now in its ninth month. The electoral result suggests an uncomfortably large following for the old regime as well as lingering mistrust of the market economics that Mr Labus personifies.

Many Serbs, including those dismayed by the result, are convinced that the strong showing for the forces of extreme nationalism is a perverse effect of Mr Milosevic's trial, which has been relayed on Serbian television. Far from discrediting the old bully, the broadcasts have convinced many Serbs that the tribunal is biased against their country.

Add to that the looming unhappiness over the fact that hundreds of thousands of Serbs are likely to lose their jobs as old state-run industries are closed down. While some western investment is beginning to flow, most of it is in industries like technology which do not require large workforces. People are also smarting from a sharp rise in electricity prices, as subsidies are phased out.

If the final result of Serbia's presidential race later this month sees the defeat of Messrs Djindjic and Labus and the market-oriented ideology which they embody, western governments will be dismayed. They had been counting on Serbia's reformers to lay to rest the ghosts of ultra-nationalism and in due course to cut a deal over the “final status” of Kosovo (see article) which would accommodate everybody in the Balkans and enable the whole region to snuggle closer to the West.

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Kosovo's final status

First, be nicer to each other

Oct 3rd 2002 | MITROVICA
From The Economist print edition

A dismal town holds a key to Kosovo's—and to Yugoslavia's—future

"I WILL win Mitrovica." That is the simple formula whereby Michael Steiner, the German diplomat who runs Kosovo for the UN, expresses his determination to extend his authority over the province's last ethnically-divided town. Not much of a prize, you might well retort, after inspecting the scruffy, depressed mining community in the very north of the province that abuts Serbia proper and is bisected by the sluggish Ibar River.

But Mr Steiner has good reason for saying that Mitrovica holds the key to Kosovo's future and hence perhaps the political future of what remains of federal Yugoslavia. This week he unveiled a plan designed to end segregation between Albanians and Serbs in the town and to revive its economy. North of the Ibar, about 67,000 Serbs—in other words, two-thirds of the Serbs who remain in the whole of Kosovo—live under the de facto sway of some local bullies called "bridge-watchers" who have defied the UN and cleansed their fief of Albanians. This reverses the situation in most of Kosovo, where Serbs live in fear of the Albanian majority.

It is in Mitrovica that Mr Steiner will succeed or fail in implementing a policy known as "standards before status". In other words, Kosovo must meet international norms of tolerance, the rule of law must be upheld and the truly free movement of its people be ensured before its future can be settled. Putting it another way, the German proconsul says that Kosovo must be a "multi-ethnic society on its way to Europe" before it can be anything else.

But even if Mitrovica is successfully turned into a bastion of UN-protected tolerance, why should the status of the province—where ethnic Albanians are only interested in independence, while Serbs insist on staying close to Belgrade—be any easier to settle?

Mr Steiner thinks that Russia may have the answer. If Kosovo is seen to be a place where Serbs and Albanians can coexist, it may be easier for Russia to shift its stand in the UN Security Council and accept the idea of the province's eventual independence. At the moment, the council views Kosovo as part of the Yugoslav federation, albeit under UN control. But when that federation breaks up next year, the council will be obliged to reconsider.

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The International Criminal Court

Uncle Sam lays down the law

Oct 3rd 2002
From The Economist print edition

Under American pressure, the EU's joint support for the court collapses

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EUROPEAN countries think any alleged war criminal should risk prosecution before the new International Criminal Court. The United States thinks American ones should not, because (this, at least, is the official reason) the allegations might be politically motivated. This week the European Union surrendered its point.

The Americans had threatened to veto any fresh or renewed United Nations peacekeeping unless they got their way. That brought a UN Security Council agreement giving them a year to make bilateral deals with individual governments to meet their wishes.

The Bush administration set about that with a will, pointing out—a standard American negotiating tactic—that Congress had just passed a law threatening recalcitrant countries with a loss of military aid if they did not exclude Americans found on their territory from being handed over to the court. Blackmail? Good heavens, no, said Colin Powell, America's secretary of state, but they know our law, don't they?

When Romania, a would-be NATO member, succumbed, the EU—which Romania also hopes to join—got worried. Would-be EU members, it said, should stick to its line. But the State Department, po-faced though fresh from its own arm-twisting right and left (by now a dozen governments have given way), denounced this EU arm-twisting as “inappropriate”, given that the candidates were not actually EU members yet.

It need not have bothered. This week the EU front collapsed. The British, Spaniards and Italians proved readier to break ranks than to break with their superpower ally. EU foreign ministers agreed that each of the 15 members could sign up with the United States to whatever it chose, subject to some EU guidelines, which are supposed to ensure that wrongdoers not sent to the ICC face their own national courts.

So ran the EU gloss. But a guideline is just that, not—at least when the EU is talking—a rule or an order, let alone a legal requirement. None of the 15 EU governments will, in fact, be subject to anything. Whether any genuinely criminal American will be, time will show.

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Norway's far north

What about rights for reindeer?

Oct 3rd 2002 | KARASJOK, ARCTIC NORWAY
From The Economist print edition

The Sami people are unhappy

OVER the past decade, Norwegians have earned a reputation as peacemakers: in Guatemala, for a while in the Middle East, now in Sri Lanka. Yet they are still to sort out an ethnic squabble of their own, between Norway's fair-haired 4.5m majority and its 45,000-strong Sami minority up in the Arctic.

The tundra of Norway's northernmost province, Finnmark, may conceal huge mineral deposits. The central government in Oslo wants profits from mining to go into its own coffers. The Sami (Lapps, as you used to know them) think differently. “We're the indigenous people, so some of the resources should be ploughed back to us,” says Sven-Roald Nystoe, president of the Sami parliament, which has modest powers of self-government. Many mainstream politicians reckon the Sami already have more than they deserve: their assembly, language rights, and subsidies for cultural endeavours and reindeer-herding. Alf Olsen, of the populist Coast Party, calls their demand a “provocation” to Finnmark's ordinary Norwegians, a majority settled there “for countless generations”. The minerals will remain underground until a compromise is reached.

The Sami have other complaints. Does Oslo understand the realities of Arctic life? They doubt it. New rules say no one but a vet may castrate reindeer. Try getting the vet when you need him in this snowy wilderness. Another new rule decrees that the boats taking tourists around Finnmark's rivers in the summer must be fitted with powerful lights. Fair enough in the south, but who needs them in the land of the midnight sun?

When the assembly met in Karasjok last month, it demanded more self-government. Meaning what, exactly? Its 39 members are not sure. Some just want more say in how Finnmark is run, some seek exclusive control over all minerals and fisheries, a few dream of full-blown sovereignty. And whom do they speak for? The Sami electoral register has just 10,000 names, only two-thirds of whom voted last time round. Oslo, in theory, accepts Sami self-determination. For a people now without even the right to geld a reindeer as their ancestors did, it may take some time coming.

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Charlemagne

Europe's Mexico option

Oct 3rd 2002
From The Economist print edition

Imagine the United States embracing Mexico, as the European Union is embracing Central Europe

“FELLOW Americans, it is time to transform our relations with Mexico. We already enjoy free trade with our Mexican friends. But tonight I propose that we should go much, much further—towards economic and political union. Let us tear down that frontier. All Mexicans will have the right to live and work in the United States. We will establish a common currency and make our laws together—on everything from cleaning up our environment to helping farmers to stay on the land. These new arrangements will put a huge financial burden on our southern neighbours, so we will have to be generous. For many years to come, our taxpayers will have to send billions of dollars to Mexico to help our friends catch up. But it'll be worth it, I promise.”

It is a safe bet that George Bush will not make a speech like that to Congress any time soon. Nor is it hard to guess the reaction if he ever tried. Yet in a couple of months that is exactly the sort of relationship that western Europeans will be asked to embrace with poorer eastern countries, when the 15-country European Union signs a deal to admit ten new members.

A far-fetched comparison? Not at all. Look at the numbers, and the parallels are really quite close. According to the OECD, Mexico's GDP per capita measured in purchasing-power terms is $9,100; the figure for Poland, the largest of the current applicants, is $9,600. (Measure the figures in unadjusted dollars and the Mexicans are about 50% richer.) Mexico's population is just shy of 100m; the ten countries lined up to join the EU, plus Romania and Bulgaria which are hoping to join soon after, total just over 100m too. Transparency International's index of global corruption puts Mexico and Poland roughly on a par.

Yet while a North American Union is still—shall we say?—a little way off, EU enlargement is rapidly approaching. On October 9th the European Commission is expected to announce that Poland, the Czech Republic, Hungary, Slovakia, Lithuania, Latvia, Slovenia, Estonia, Cyprus and Malta (in descending order of population) should be ready to sign a deal at the end of the year. Barring political mishaps, that would mean that they will join the club in 2004. It will be the culmination of a long and winding road that began with the collapse of the Berlin wall in 1989. Central Europeans, and even Americans, have sometimes castigated the EU for dragging its feet over admitting the countries of the former Soviet block. One Polish minister complains: “We overthrew communism without much help, and westerners have enjoyed a huge bonus in extra security and prosperity as a result. And yet more than a decade has passed and they are still keeping us waiting. It's simply incredible.”

But, as the Mexican parallel suggests, there is another way of looking at it. By embracing eastward enlargement, western European politicians are asking their voters to make a visionary leap of faith. Europe's leaders argue that enlargement will greatly strengthen Europe's stability and prosperity. Democratic institutions will be locked into place in Central Europe's young democracies. Potentially unstable countries, some of them with disputed borders, will be tied into a European Union where such disputes are settled in a civilised fashion. Trade and investment will be boosted and everyone will become richer. Just as the Spanish and Irish rapidly caught up with the economies of the other countries in the EU after they joined the club, so the Poles, Czechs and others will become as rich as their western cousins. And the slow-coach economies of western Europe will also benefit, getting a welcome boost from a young, energetic and educated labour force to the east.

These arguments are generous in spirit and probably sound. But they are also rather abstract. The average western voter is more likely to concentrate on less lofty, short-term issues—such as the cost of subsidies that the Union's new members will be gobbling up, competition from cheap eastern labour,

fears about flows of immigrants from the east and a general impression that the new democracies of the east are less stable and more corrupt than their western neighbours.

It is precisely because the average western voter is thought to harbour these unworthy thoughts that he will not be asked to vote on enlargement. In the middle of this month the Irish will have a referendum on the Nice treaty, but even that is only indirectly about enlargement. A senior German diplomat justifies the refusal to put enlargement to the vote by arguing that the big decisions in the European Union have always been made by elites, and have then gained popular acceptance later. “If we had had a referendum on the Treaty of Rome [which set up the original European Economic Community, the EU's progenitor, in 1957], people might have rejected it on the grounds that it raised the price of bananas,” he shrugs.

I suppose we have to pay for you

It is not that today's EU countries are blind to the pitfalls of enlargement. Characteristically, however, most of the issues that really bother diplomats and politicians in Brussels are to do with the operations of the EU institutions themselves, rather than enlargement's economic and social implications. It is already very hard for the Union's current 15 members to agree on common policies. Add another ten to the mix, and there is a threat of institutional paralysis. In particular, the Eurocrats fear a huge rumpus over the EU's budget and over farm and development subsidies, which account for 80% of spending. Big payers into the European budget, especially the Germans, are already chafing at the cost of subsidising the rest of the EU. But the ten would-be new members have a great many farmers and poor people, who are natural candidates for subsidies. Resolving the issue will cause bitter ructions in an enlarged Union. One member of the EU team negotiating the current wave of enlargement jokes nervously that “a lot of us are hoping to have left Brussels by the time the consequences of enlargement have sunk in.”

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The economy

Steady as she goes

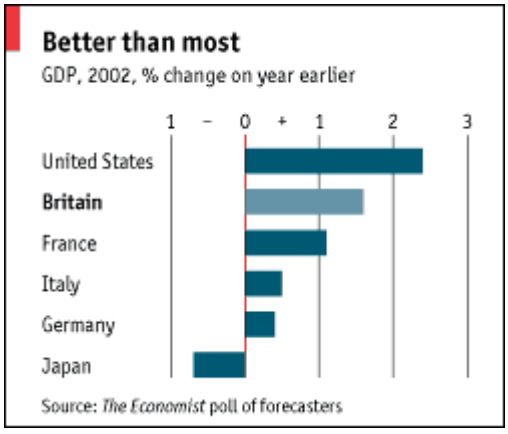
Oct 3rd 2002
From The Economist print edition

Hopes for a rapid recovery are fading, but Britain should continue to out-perform most other big economies

TONY BLAIR told this week's Labour Party conference: “we're at our best when at our boldest.” Of all the pledges the Labour government has made, its boldest has been to pledge an end to boom and bust. This hostage to fortune is as politically important as it is bold. Economic stability underpins not just Labour's ambitions to improve the public services through a sustained programme of higher spending but also public confidence in Labour's ability to manage the economy.

So far, the government has fulfilled its promise. The British economy, so vulnerable in the past to global setbacks, has proved remarkably resilient to the world slowdown that started last year. Twenty countries, accounting for half the world's output, have been or are in recession, Gordon Brown, the chancellor of the exchequer, told Labour Party delegates on September 30th. For once, Britain (though not Scotland) has been the exception: the economy has continued to grow, albeit sluggishly, since early 2001. And in the second quarter of this year, GDP was 0.6% higher than in the first quarter.

But in the past three months, the economic outlook has darkened. The danger is not that Britain will lurch into recession, rather that recovery will be weaker than expected. The Treasury is now conceding the inevitable: a senior advisor to the chancellor made clear this week that the ambitious growth forecasts made in the April budget will be trimmed in November's pre-budget report.



Those predictions were that the economy would grow by 2-2.5% in 2002 and by 3-3.5% in 2003. After a lacklustre performance in the first quarter, when output grew by only 0.1%, this year's forecast was bound to be hard to meet. *The Economist*'s panel of economic forecasters now expects growth of 1.6%. More worryingly, it has trimmed the forecast for 2003 to 2.7% from 2.9% a month ago. This would mean the chancellor undershooting his growth forecast, both this year and next, by about half a percentage point.

There are two main reasons why economic prospects are looking gloomier. The first is that recovery in

other major economies is faltering. The outlook for the euro area is especially bleak, with growth expected by *The Economist*'s panel to be just 0.8% in 2002 and 2.0% next year (down from 1.0% and 2.4% respectively last month). This means that export markets will grow less rapidly than had been hoped, so Britain's manufacturers will suffer. This week's report from purchasing managers showed no growth in manufacturing in September.

The second and related reason is that share prices have tumbled still further. The value of the FTSE 100 top companies slumped by a fifth in the third quarter. September was the worst month since the crash of October 1987. Falls on this scale slash household wealth. As individuals and pension funds strive to rebuild their assets, saving will rise, which will reduce future spending growth. Businesses are also likely to trim their investment plans since falling equity prices make it more difficult and expensive for them to raise outside finance.

Britain is especially vulnerable to reverses in stockmarkets, mainly because households are more exposed to equities than in other countries. Simulations by the OECD suggest that a 20% fall in the real value of the British stockmarket cuts consumer spending by 1% and GDP by 0.4% after two years. Stockmarkets have been falling for over two years. But until now, the impact of lower equity wealth in Britain has largely been offset by rising housing wealth. This has boosted consumer spending as households have borrowed back some of that wealth through mortgage-equity withdrawal. Such borrowing—secured on but not invested in housing—amounted to over £8 billion ($11.4 billion) in the first quarter of 2002; in relation to household disposable income, this was the highest for 12 years. Small wonder that consumer spending in the first half of this year was almost 4% higher than in the same period in 2001.

House prices are continuing to surge across the country, rising by 22% in the year to September, according to the Nationwide index. However, it looks increasingly as though the house-price boom is now over in London. Steven Bell, an economist at Deutsche Asset Management, is forecasting a 10% decline in London house prices over the next year and smaller falls in the rest of the south-east—enough to cool down the national housing market in 2003. The result: the long sustained consumer-spending boom will finally come off the boil.

Brown's boost

The other main impetus to the economy in the past two years has come from the government's big spending programme. The effect has been to create a switchback in the public finances, injecting extra demand into the economy. In the financial year ending March 2001, the public sector ran a huge surplus of £16 billion. This turned into a small deficit of £1 billion in the year to March 2002, forecast in the budget to rise to £11 billion in the current financial year. But this marks the end of the chancellor's deliberate loosening of fiscal policy: taxes are going up next year to pay for higher public expenditure.

The effect of lower growth will be to add more red ink to the Treasury's forecasts—probably about an additional £3 billion this year. But unlike his fellow finance ministers in the euro area, required by the EU's stability pact to balance their budgets, Gordon Brown does not face pressure to curb borrowing in an economic downturn. Furthermore, there is scope for the Bank of England to cut interest rates, which it may do as early as next week. The Bank has plenty of room for manoeuvre since inflation remains firmly under control. With growth prospects now being trimmed again, a cut in rates—which the Bank discussed in early September—looks increasingly probable: financial markets are pricing in a cut of at least a quarter-point by the end of the year.

Recovery may be more modest than expected, but Britain will still grow more robustly than the euro area, not least because of its ability to set both fiscal and monetary policy according to its own economic requirements. At Blackpool, Tony Blair reaffirmed his desire for Britain to join the euro in this parliament. Paradoxically, the more successful the government is in meeting its bold pledge to avoid boom and bust, the more difficult it will be for him to fulfil that equally bold wish.

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Wind power

Crofters' Klondike

Oct 3rd 2002 | EDINBURGH
From The Economist print edition

It's western Scotland's turn to get rich from energy

IN THE Scottish Highlands, something of a gold rush is on. Barren hillsides on which sheep farmers eke out a few hundred pounds might suddenly be worth a fortune as wind farms. West-coast landowners, who have watched the east of Scotland grow rich with oil, now see their chance to cash in.

Britain uses less renewable energy than any other rich European country. The government wants to change that. It is therefore requiring all electricity generators and suppliers to buy some of the power they sell—3% next year, rising to 10% by 2010—from renewable sources. Companies that fail to hit the target will be fined and the money given to those that do.

Just under 3% of Britain's electricity is currently generated from green sources, about a third of it from wind power. Since wind is the cheapest of the renewable technologies, the search is on for new places to put turbines.

The windiest places are in the west, especially in Scotland. So far, only 18 of Britain's 72 wind farms are sited north of the border. But, thanks also to Scotland's laxer planning regime, another 100 are in development and a similar number is under consideration.

The money's good. A modestly sized wind farm of 30 turbines could yield about £75,000 ($117,000) a year. Indeed, the windswept Western Isles, which have suffered years of decline, are busily re-branding themselves as the “renewables capital of Europe”. There's a scheme for a 600 MW wind farm, dwarfing the present total British output of 450 MW, on land owned by the Stornoway Trust, which holds land on behalf of locals. It would be paid about £2m a year in rent.

There are a few snags. The Stornoway scheme is being promoted jointly by AMEC, a big construction firm, and British Energy, a nuclear generator which got a £410m loan from the government last month to stop it going bankrupt, so putting the wind scheme in doubt. Quite apart from British Energy's financial problems, Enron's collapse means that banks are looking at energy schemes somewhat sceptically these days.

Opposition to wind farms is growing. Environmental groups like renewable energy, but worry about wind farms—partly because they are so ugly, and partly because digging turbine foundations damages moorland ecosystems.

Wind power is a bit more expensive than power generated from fossil fuels, and plugging wind farms into the national grid raises costs further. About £1.6 billion needs to be spent to get the Scottish renewable energy to English markets. At current low electricity prices, that may be hard to justify, in which case generating companies may opt to pay the fines rather than buy green.

Long-term, the main worry is that the demand for wind and other renewable energies is artificial. If a future government decides that forcing electricity companies to produce uneconomic power is a bad idea, a lot of wind farms will find themselves on the rocks.

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Sex industry

Stiff competition

Oct 3rd 2002
From The Economist print edition

Liberalisation is making the adult entertainment business respectable

THE mood at this week's board meeting of the newly formed Organisation of Adult Trades and Services (OATS) was surprisingly earnest. A policeman from the vice squad took copious notes while a distributor of hard-core videos, Anna Kieran, denounced the “market-trader mentality” of “cowboys” who give the industry an “image problem”.

Along with negotiating lower insurance premiums, credit card charges and other prosaic questions, the big issue was planning the sex industry's event of the year, the Erotica exhibition in November. Through the new-found respectability came the occasional glimpse of the industry's old ways. Spearmint Rhino, the world's biggest chain of strip clubs, has been banned from the exhibition after its boss in Britain misbehaved at last year's event. “He wouldn't listen, and in the end I had to get one of my bouncers to smack him,” recalled a huffy sex baron.

Although flirting and pole-dancing lessons are planned, the trade fair will mainly feature the products side of the industry—pornography, sex toys and the like. These days, most of this part of the industry is legal. Definitions of obscenity are now so lax that little apart from child pornography is banned. Since a change in the rules about hard-core videos in July 2000, the number of films applying for the steamy R18 certificate from Britain's film censors has quadrupled. Distributors pay up to £2,000 ($3,100) for the privilege—and fume about illegal competitors who import unlicensed videos, or sell pirated versions.

As the industry has been legalised, so it has grown up. These days bits of it look much like any other business. The trade association has hired a professional lobbyist, and hopes to commission academic research to back its push for consistent, evenhanded regulation and tougher enforcement. Its members accept there is plenty of room for more consolidation, efficiency and competition. Margins are huge, the market murky. The industry hopes its products, like contraceptives in the past century, will become cheap, reliable, and unremarkable.

But for the other half of the industry, sex services, there is little early prospect of gaining comparable acceptance. Although prostitution itself is not illegal in Britain, almost everything to do with it is. If prostitutes (sex workers, in industry parlance) get together and set up a brothel, they can be prosecuted for living off each other's “immoral earnings”.

As a result, proper policing and regulation are impossible. In the legal twilight, prostitutes are vulnerable to violence and extortion. Dozens are murdered every year. Cheated consumers rarely complain. Those trying to run a respectable business find it difficult. Paul Edwards, an OATS member who owns two massage parlours in Northampton, complains: “We do everything right and legal—apart from what we actually do.”

A new push for respectability comes from the prostitutes themselves, who are increasingly vocal and well-organised. A grandly named International Union of Sex Workers has affiliated to a mainstream trade union, the GMB. Its biggest success so far is a fully unionised lap-dancing bar, Majingo's, in London's Docklands. But there is a long way to go. The union has only 200 members. Britain has an estimated 90,000 prostitutes.

The government is planning another look at prostitution laws. Decriminalisation would not solve all the industry's problems—the details of licensing brothels, in particular, are tricky, when the line between commercial sex and other kinds is so fuzzy—but it would help. Could paid-for sex become as socially acceptable as, say, physiotherapy? Many punters would miss the sleaze.

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More sex

Kiss, tell, cringe

Oct 3rd 2002
From The Economist print edition

British politicians should stick to the cocoa and biscuits

SAD but typical. That is the fairest verdict on the frenzy surrounding Edwina Currie's diary, in which she, formerly a minor figure in the Conservative Party, reveals an affair with John Major, a colleague who went on to become prime minister.

PA

Fancy a nice cup of cocoa?

It is hard to know which of the innocent bystanders to feel sorriest for: Mrs Currie's children (who didn't ask to be born of a publicity-crazed mother); her loyal, shy ex-husband (whom she humiliates for his supposed sloth, fatness, and ill-health); Mr Major's wife (also shy, also humiliated); her party colleagues (whose attempts to relaunch their party's pitiful fortunes have been wholly eclipsed), or for the country itself, wallowing in a peculiarly British cesspit of prurience and prudery.

It is different abroad. Top French, German and American politicians often conduct discreet but barely disguised affairs which attract little or no public comment. It took Clintonesque excesses to put the presidential sex life into the headlines. The British public seems oddly scandalised by any thought that bedtime should involve more than cocoa and biscuits; the British media—among the most competitive in the world—panders astutely to these foibles.

That Mr Major didn't promote the greedy, vengeful Mrs Currie to the cabinet looks a wise decision, although his reputation for honesty and solidity does look a bit dented, as does the wisdom of his “back to basics” campaign for strict moral values. Two magazines which paid him hefty libel damages over an alleged affair with a Downing Street cook want their money back.

Mr Major terms the affair “shameful”. All too true, especially now.

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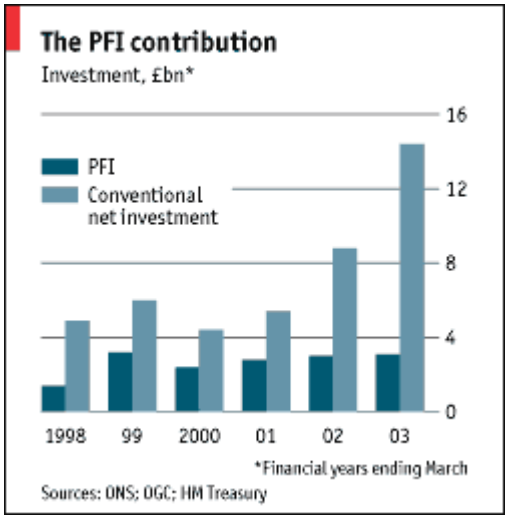
Labour and the unions

A bloody nose

Oct 3rd 2002 | BLACKPOOL
From The Economist print edition

What the tussle over the private-finance initiative is really about

SINCE Tony Blair became Labour's leader in 1994, he has been used to getting his own way at party conferences. But not at Blackpool this week. After a noisy debate in which a treasury minister was barracked, the unions got their way on a resolution calling for a review of the government's private-finance initiative. They might as well have spared themselves the effort: first Gordon Brown, the chancellor of the exchequer, and then Tony Blair made clear that PFI was here to stay.



The ruction resembles one of the theological disputes that used to rock the early Christian church. It turns on a number of tricky doctrinal issues like value for money and the integrity of public-sector accounting. This makes it agreeably obscure to all but those involved. But it hits all the emotional buttons—old versus new Labour, public versus private, producer versus consumer interests.

The PFI—invented by the Conservatives, enthusiastically embraced by Labour—breaks with the usual mould of public-sector investment, in which the state simply procures new assets like schools and then takes possession. By contrast, a PFI deal gets private contractors not just to build but to maintain public assets, and in some instances, like prisons, to run them. Crucially, the two kinds of investment are financed quite differently. Normal public investment is financed up-front by taxes or public borrowing. PFI deals are financed by private money, which is then repaid by the taxpayer, along with other services related to the contract, typically over periods of about 25 years.

The unions' main grievance about PFI is that it is a form of “creeping privatisation” in which more and more public-sector workers are transferred into private firms. The result is a “two-tier” workforce. In his conference speech on October 1st, Tony Blair offered the unions an olive branch: “work with us on the best way of delivering the service and we will work with you on ending the two-tier workforce.” But even though the government has given ground to the unions on this issue, it cannot ultimately guarantee identical rights to new workers recruited by the private contractors.

The unions' gripe is in fact a strong argument for PFI. Many of the problems of the public services arise because of rigid employment practices. National pay scales with limited regional variation mean that teachers and nurses are under-paid in London and the south-east, leading to severe labour shortages. One of the main reasons that new prisons built through the PFI have proved a success is that they have been able to recruit their own staff and bypass the cussedly conservative Prison Officers' Association.

The unions are on stronger ground when they question whether PFI contracts represent value for money. As a general rule, they are estimated to save about 10% of the cost of traditionally procured investment. But in some areas like schools and hospitals, the cost savings are as low as 3%, according to the Institute for Public Policy Research. And these estimates, which rest on contentious assumptions and calculations, are necessarily tentative since the contracts are so long. The Public Accounts Committee recently sounded an alarm about how PFI contracts were working out after initial construction had been completed. It highlighted the fact that almost a quarter of public-sector bodies with operational PFI investments thought they were subsequently getting less value for money, partly because of high prices for additional services.

Given such worries about value for money, the unions' call for a review is not unreasonable. As John

Edmonds, general secretary of the GMB union, said at Blackpool: “If the government is so right and we are so wrong, why does the government not want a review so they can prove their case?”

The answer, loud and clear, from both Gordon Brown and Paul Boateng, the unfortunate Treasury minister who was barracked, was also the slogan of the conference: “schools and hospitals first”. The chancellor spelt it out: “But for PFI we simply could not have started so many so quickly in so many communities.” The PFI, he said, offered additional private money to finance more public investment.

This justification is a poor one, hardly excusable even when made to party delegates. For one thing, the real cost of any investment is the resources that it uses, which is not changed by the method of financing. For another, the additional investment is not conjured up from thin air. It simply means that future rather than current taxpayers have to pick up the costs of servicing and paying off the debt. And since net public-sector debt is currently very low—just 30% of GDP—the government is well-placed to borrow more.

The snag is that this would add about a further £4 billion a year to borrowing—equivalent to 0.4% of GDP. The chancellor is reluctant to disclose this additional cost in the public finances, not least since they are scheduled to deteriorate quite sharply anyway, because of the government's numerous other spending commitments. For all the fighting words about the PFI, its principal virtue to Tony Blair and Gordon Brown, as to their Conservative predecessors, is that it hides the true cost of public-sector spending programmes.

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Secondary schools

Not very special

Oct 3rd 2002
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Policy on secondary schools isn't delivering the results government wants

Get article background

IN AN impassioned speech at this week's Labour Party conference, Tony Blair announced that it was time to “move to the post-comprehensive era”, arguing for “a range of schools for parents to choose from”, and a system open “to new and different ways of education, built round the needs of the individual child”.

Specialist schools are the centrepiece of this vision. These are comprehensive schools which have chosen to concentrate on one of eight areas such as science, languages or maths. Having raised £50,000 of private sponsorship, they then gain extra state money: a £100,000 capital grant and an annual £123 per pupil for four years. Altogether, that means an extra 4% on an average school's budget. Unlike ordinary comprehensives, they may also select up to a tenth of their intake by ability.

Specialist schools developed out of the technology colleges introduced under the Tories in the late 1980s. When Labour came to power in 1997, there were nearly 200 of them. There are now 1,000—a third of state secondary schools in England and Wales—teaching about 1m pupils. The government wants 1,000 more by 2006. On present form, that seems on track: some 300 new specialist schools were designated last year alone.

The extra cash means better kit, smarter buildings, stronger administration, and more high-powered training for teachers. Sir Cyril Taylor, chairman of the Technology Colleges Trust, also highlights the role of tough achievement targets and the influence of the schools' sponsor-governors, many of them high-powered types from the world of business or management. A “locomotive effect”, he says, means that high standards in one area raises performance all round.

Teaching unions dislike specialist schools. They disapprove of the introduction of private money into the state system, and they complain that because specialist schools are allowed to select pupils, they will cream off talent from ordinary comprehensive schools—described rather tactlessly as “bog-standard” by Alastair Campbell, Tony Blair's chief spin-doctor. But so far, that does not seem to be happening. Only around 6% of specialist schools, it turns out, select their pupils.

So are these schools delivering the improvements that the government hopes for? David Jesson, a professor in the Centre for Performance Evaluation at York University, has shown that pupils in specialist schools are outperforming the less fortunate elsewhere. Specialist schools, he says, do 5% better than other schools at GCSE level in terms of “value added”—stripping out external factors such as class background, in other words.

That barely justifies the hullabaloo. If an extra 4% on a typical school's budget really brings only 5% improvement, the returns to the taxpayer look pretty slim. Not new, then, and not really working that well. It hardly seems enough to put specialist schools at the centre of a shiny new education policy.

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Census

Countless people

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Holes in the census

SOMEONE'S sums are clearly wrong. First results from last year's census, released this week, seem to suggest that Britain's population is about a million lower than expected. The gap is measured against predictions based on results from births, deaths, past censuses, immigration figures and other demographic trends.

There are two explanations. The official line is that a lot more Britons than previously realised, mainly young men, have gone abroad and not come back. Len Cook, head of the office that does the census, says that estimates of a 250,000 yearly net outflow were more than 50,000 short over the past decade, added to which the 1991 census overcounted by more than 300,000.

Maybe. But it seems odd. This supposed tide of young male emigrants has not been picked up by other statistics. Nor is it much supported by anecdotal evidence. Why should there be so many men staying abroad and so few women, given that work, study, travel and marriage in foreign countries attract both sexes more or less equally? The other explanation is that the census itself is faulty, failing in particular to catch hundreds of thousands of young foreign men known to have entered the country in the past decade or so.

That, believes David Coleman, professor of demography at Oxford, is much more likely. Foreigners uncertain of their status may well shy away from completing the census form, and also evade follow-up surveys aimed at plugging the gaps. It is revealing that the worst responses to the census were in inner London—which also seems to be the part of Britain most foreigners like to live in.

The census is the basis for planning everything from schools and hospitals to pensions and housing. Wrong numbers mean wrong policies. Mr Cook wants to plug the data gap by hiring more census workers to make follow-up visits to households that don't respond. Mr Coleman believes the solution is to scrap the census and introduce a continental system of population registration, under which the state knows where you live and it is an offence to dodge the system. Coupled with new ways of measuring the population, that would bring greater clarity, he argues: as it is, the size of the population is “anybody's guess”.

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Bagehot

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Oct 3rd 2002
From The Economist print edition

The gap between Tony Blair and his party—and, more dangerously, his chancellor—has widened

TOWARDS the end of his magisterial lecture to a fractious, uneasy Labour Party conference, Tony Blair issued a warning to his audience: “You've lost your love of discipline for its own sake. I've lost my love of popularity for its own sake.” His message was that he was not going to be deterred from doing the right thing—over both Iraq and public-service reform—by the kind of internal dissent that has surfaced in Blackpool this week. “Displeasing people; pockets of disillusion; impatience and frustration. These are not the hallmarks of this Labour government. They are the hallmarks of government,” he said.

Whether the MPs, the subscription-paying members and the affiliated trade unions that together constitute the Labour Party have ever actually enjoyed the formidable discipline they have managed to maintain since Mr Blair became its leader in 1994 is questionable. What they shared, however, was a willingness to subordinate deeply held political convictions to the need to make Labour electable after 18 years of defeat and humiliation. Making Mr Blair their leader was a part of that sublimation. They didn't much like him or large parts of his “modernising project”, but if accepting them was the price of a Labour government, so be it.

As for Mr Blair, he has always understood it was his popularity in the country—his unerring ability to reach out to a wider community of interest than any Labour leader before him and to articulate the hopes and fears of middle England—that was the source of his indispensability to his party. However hard he attempts to hit his party's buttons—and he tried again this week when referring to “the great progressive 1945 settlement” and talking (actually quite movingly) about the impact of British aid in bringing hope to a benighted corner of Africa—he cannot quite do it.

Mr Blair now seems to accept that his pact with the Labour Party is becoming increasingly frayed. The party no longer believes that he is essential to remaining in power. Whereas a second landslide victory should, in the normal course of events, have reinforced Mr Blair's dominance, it may, paradoxically, have weakened him. Unprecedented electoral success combined with the Tories' failure to stage any kind of recovery, or even to look capable of doing so at some time in the distant future, has bred complacency bordering on arrogance among Labour MPs and trade-union leaders.

The Labour Party no longer believes that Mr Blair is essential to remaining in power

If sustaining Mr Blair and his personal vision is no longer deemed a necessary condition of office, it follows that it is no longer treasonable to express opposition to his leadership. And in Mr Blair's willingness to go to war with Iraq and his prescription for public-service reform—dependent as it is on breaking up the public-sector monopolies that were created by that “1945 settlement”—the prime minister's many critics believe they have an adequate *casus belli*.

Mr Blair would not be human were he not a little dismayed by this ingratitude. Yet it seems to have made him increasingly reluctant to compromise if that means being diverted from his course. His surrender to the unions last year over the principle that private-sector involvement in public-service delivery should not mean a “two-tier workforce” has gained him nothing. The unions have simply pocketed this very large concession, while stepping up their campaign against the private finance initiative (PFI). No wonder Mr Blair increasingly seems to regard his party as just another interest group which has to be either appeased or confronted.

Gordon's grouses

The most interesting question is whether that includes Gordon Brown. Although the chancellor went out of his way to praise the prime minister's “strong leadership” on Iraq (at least he didn't say brave) and was dismissive of the union-backed revolt against PFI, the tension that is building between him and Mr Blair over public-service reform is potentially far more serious than their previous differences over the euro. Mr Brown's defence of PFI was notable for saying almost nothing about its real benefits over public funding, which, Mr Blair believes, are cultural rather than financial. For Mr Brown, it is simply a matter of being able to build lots of schools and hospitals which his celebrated fiscal prudence would not otherwise allow.

The current flashpoint between the chancellor and the prime minister is the establishment of the independent “foundation” hospitals that the health secretary, Alan Milburn, sees as critical to the transformation of the NHS into a locally accountable service. Mr Milburn, supported by Mr Blair, says: “This is the right time to acknowledge the one great truth that we all know in our hearts: that a service employing one million people in thousands of hospitals and health centres...can't be run from Whitehall.” Not in Mr Brown's heart it isn't.

On one level, Mr Brown opposes the proposal to allow new hospitals to borrow without Treasury approval in order to expand and develop new services. More fundamentally, he rejects the idea that foundation hospitals should be allowed to compete with other NHS institutions, creating a “two-tier” health service. As Mr Brown said in his conference speech: “What we say and do about the NHS is not just about the future of our public services, but about the character of our country. It is an affirmation that duty, obligation, service, and not just markets and self-interest, are at the very heart of our idea of society—at the heart of what it means to be a citizen of Britain.”

Ignoring his chancellor is even more dangerous for Mr Blair than ignoring his party. For all his display of confidence, two things stand out at the end of this week: the great difficulty he will have in realising his public-service agenda; and his vulnerability should the cabinet split, as is entirely possible, over British involvement in a non-UN sanctioned attack on Iraq.

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The market for chief executives

Bosses for sale

Oct 3rd 2002
From The Economist print edition

Are headhunters to blame for the damaging cult of charisma?

WHEN Bank One got into a mess in 1999, Andrea Redmond, one of Russell Reynolds's top headhunters, found a sparkling new chief executive: Jamie Dimon, recently shoved out of Citigroup, a victim of political infighting. “The board was very impressed by how execution-oriented he was,” she recalls, “and he has certainly proved to be an excellent executor.”

Mr Dimon has been a ferocious cost-cutter, but it is still not clear if he will be able to turn the bank round. More obvious is the touching faith of the Bank One board in the power of one man to transform a company, especially when its industry has hit a rough patch. Mr Dimon's appointment is examined in a new book, “Searching for a Corporate Saviour” (Princeton University Press), by Rakesh Khurana of Harvard Business School, one of a growing band of economists turning a critical eye on corporate management.

Hiring Mr Dimon, he argues, was a classic case of a firm picking an outsider as boss when it is in a mess. The board's unreasoning faith in the ability of a superstar leads them to offer huge rewards. Hiring a high-profile outsider can destabilise the firm and destroy the loyalty of senior managers, including good internal candidates. It rarely restores the firm's fortunes.

For the rise of the myth of the superstar boss, Mr Khurana blames mainly the big executive-search companies. They run the job market for chief executives. Any big company that considers recruiting from outside will turn to somebody like Ms Redmond or Tom Neff of Spencer Stuart. Both vigorously deny that their search activities do corporate harm. Ms Redmond argues that some companies are in such a mess that it is extremely hard to find anybody willing to take on the top job. That view is born of her “toughest assignment ever”—the superhuman task of finding someone to run troubled United Airlines. As for Mr Neff, ask him how many of the chief executives he places work out for the companies, and he replies: “100%”.

Well, maybe. Certainly, finding new bosses is one of the few bits of the search industry that is reasonably robust. By 2000, headhunting had boomed so fast it had 34-40% overcapacity, says Mel Connet, a recruiter from Silicon Valley who specialises in finding top executives for technology firms. Since then, the two main publicly traded headhunting firms, Heidrick & Struggles and Korn/Ferry, have each laid off more than a third of their staff. The world's sixth-largest search firm, Ray & Berndtson, recently went bust and was acquired by A.T. Kearney. Revenues have plunged (see chart).

Recruitment of top bosses is faring much better than the hiring of middle managers, a market that is still moribund . Dennis Carey, who specialises in chief executive recruitment for Spencer Stuart and is co-author of a recent book on the subject—“CEO Succession” (Oxford)—says cheerfully, “I've never been busier.” He has just been rebuilding the top tier at Tyco International, recruiting six new board members, a new chief finance officer and a new legal counsel—as well, of course, as a replacement for the disgraced chief executive, Dennis Kozlowski. “Troubled companies are a great source of activity for executive search—and there are a lot of troubled companies out there,” he says. You can see what he

means: he has just embarked on the search for a new boss for WorldCom.

This little piggy went to market

Even if a company is in dire straits, is an outsider likely to be the best person to rescue it? Mr Khurana insists that is rarely the case. As markets go, that for chief executives works in a spectacularly unsatisfactory way, he argues. Its three key characteristics are: a small number of buyers and sellers; high risks to both; and widespread concern about the market's legitimacy. The selection process puts socially defined characteristics, such as the outsized reputation of an executive like Mr Dimon, ahead of relevant practical skills and experience (Mr Dimon had little knowledge of retail banking or credit-card operations, two of Bank One's biggest and, in the second case, most problematic businesses).

The market is also characterised by extreme secrecy. Companies may run advertisements for technicians and accountants, but they rarely advertise the top job—and if word of a candidacy leaks out, the person concerned usually has no option but to rule himself out of the race. Mr Khurana argues that the search process, with its emphasis on confidentiality, restricts the hunt for potential candidates and puts enormous power in the hands of the recruiting firm. And, precisely because it is such a restricted and secretive market, it is bad at price-setting. Hence the immense sums that companies offer outsiders to persuade them to take the job, sums that then influence the pay of other chief executives. Because a search firm's fee is typically one-third of a new recruit's negotiated annual cash compensation, they have every reason to push up pay.

True, the market finds only a small (but rising) minority of all the bosses appointed each year. Most big firms still choose an insider for the top job—though many boards assume their inside recruit would be available for hire in the marketplace, and so still pay the “market” price for him. Once a firm opts to look outside, any internal candidate inevitably comes to look less impressive than the names on recruiters' lists: 75% of outsiders appointed in 1985-2000 had previously been chief executives or company presidents.

The sort of boss this process delivers does not necessarily have the skills to run the new firm well. That is not entirely the fault of headhunters. Boards want—or wanted—big names, to boost the share price and impress analysts, says Mr Connet. “It used to be a case of ‘Get me a name, even if they can't run the firm.’ Boards didn't seem to care if a person would fit in: they just cared about marquee value.”

In fact, when Jim Collins wrote his bestseller, “Good to Great” (HarperCollins), a study of companies that did outstandingly well in their industries, he found that the best companies were definitely not those whose bosses had marquee value. Rather, exceptional companies were disproportionately likely to recruit their bosses internally. And those they selected were half as likely to appear in newspaper articles as the bosses of less successful companies. “Quiet, workmanlike, stoic leaders bring about the big transformations,” he argues.

The market may now be taking this discovery on board. Companies still want ability and passion, reports Mr Carey, but integrity has shot to the top of their list of desirable characteristics (perhaps not surprisingly, if you sit on the Tyco or WorldCom board). And would-be chief executives are warier of overpromising and underdelivering. “There is appropriate trepidation”, he says, “about blowing one's own trumpet.” Joseph Daniel McCool, editor of *Executive Recruiter News*, an industry newsletter, sees the same trend. “The trophy CEOs have been replaced by the everyday executive with a long track record of

“The trophy CEOs have been replaced by the everyday executive with a long track record

performance. It's less about personality, and more about past performance and integrity.” To make sure that recruits have spotless pasts, companies now hire “investigative consultants”, he says, to run background checks.

of performance”

The market may have altered, but its inherent inefficiencies remain. Even Mr Khurana is stumped for ways to make the market for bosses work much better. Letting shareholders elect their chief executive, perhaps from a slate of competing candidates, is likely to remain the stuff of corporate-governance fantasy. Changing the way headhunters are paid might discourage them from ignoring internal stars in favour of external candidates, particularly expensive ones. But they are likely to remain at the heart of the market, for the only practical alternative is for the board to do the search itself—a hunt that might not extend far beyond the 19th hole of the nearest golf club.

The best hope is that boards, closely watched by today's more vigilant large shareholders, will be clearer about the problems a new boss must solve. They should forget about hiring another firm's boss on the strength of his eloquence on CNBC, and care more about operational skills and an ability to read a balance sheet. In the market for bosses, as in any other, the best way to improve efficiency is for consumers to remember the ancient rule of *caveat emptor*, or buyer beware.

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Celebrity ex-bosses

But not forgotten

Oct 3rd 2002 | NEW YORK
From The Economist print edition

Out of work but still in the limelight

HIS glory days are over, yet there is no keeping a celebrity boss out of the public eye. So what if you can no longer do an initial public offering or spend billions buying a rival? Make a splash instead by giving some of your fortune back; or if all else fails, get arrested.

AP

Mr Fastow's new handcuffs aren't golden

On October 1st, Gary Winnick, founder of Global Crossing, a bust telecoms firm, told a congressional committee that he will donate $25m to be shared by the firm's current and ex-employees whose pensions tanked when its share price collapsed. Public opinion was split. Following Jack Welch's renunuciation of millions of dollars worth of baseball tickets, cut flowers and the like from his old company, General Electric, had Mr Winnick claimed new moral high ground? Or should he have given more, having sold his shares, pre-plunge, for $734m? Ever the leader, Mr Winnick urged other telecoms executives to “step right up and write a cheque”.

Such voluntary acts of generosity may be beyond Andrew Fastow, Enron's ex-chief financial officer, who on October 2nd was charged with money laundering, securities, wire and mail fraud, and conspiring to inflate Enron's profits and enrich himself at the company's expense. Mr Fastow's much-anticipated “perp walk” in FBI handcuffs follows an earlier guilty plea by an underling, Michael Kopper. The question is, will Mr Fastow now incriminate his former bosses, Jeffrey Skilling and Kenneth Lay?

The feds appear unwilling to make much distinction between giving it back and having it taken away. “Our strategy is straightforward”, Larry Thompson, the deputy attorney-general, told reporters. “We aim to put the bad guys in prison and take away their money.”

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American corporate profits

Damned if you do

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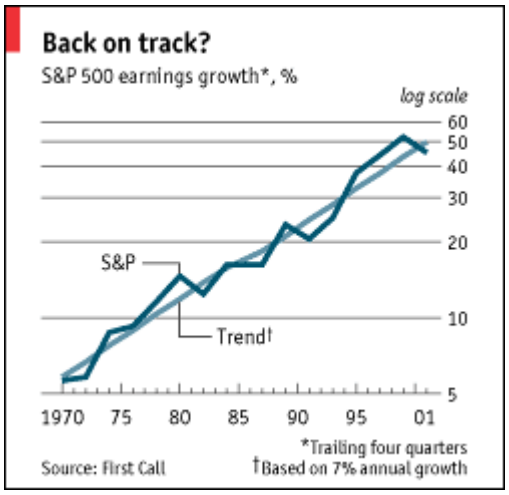
Firms are struggling to find better ways to talk to their shareholders

WAL-MART says it is “on track” to meet its quarterly profit targets. Dell says it will meet its goals. Under pressure, Michael Eisner, boss of Disney, promises “strong, double-digit” earnings-per-share growth in 2003. “Making the numbers”—the much-derided practice of setting, then meeting, short-term profit targets—continues to flourish in America. For most big companies, the short-term outlook for profits is still the main focus of communication with shareholders and the media.

Wasn't this all supposed to change? Surely Wall Street's blissful forecasts of future profits—and the pressure on firms to meet them—lay behind every accounting scandal, from Enron to WorldCom? Bosses such as James Kilts of Gillette and Barry Diller of USA Networks have publicly denounced the practice. Richard Parsons, boss of AOL Time Warner, has acknowledged that his firm had fallen into an earnings trap. “We were penalised”, he told investors in January, by the “high expectations we ourselves created.”

Why, then, have most firms failed to kick the habit? At its core, the problem is a persistent gap between expectations and reality. Over the long run, big American companies have reported profit growth of about 7% a year (see chart). Even in these hard times, however, Wall Street's shrinking band of analysts refuses to set their sights so low. According to First Call, a research firm, on average analysts expect earnings per share for the S&P 500 to grow by 13.1% a year over the next five years. What is the lowest growth they have forecast since 1986? 10.8%.



In the late 1990s, analysts became more optimistic than ever. Long-term earnings forecasts peaked, in August 2000, at 18.7%. Worse, says Peter Kontes of Marakon Associates, a consultancy, bosses began to believe that what they told Wall Street actually mattered. As small investors gobbled up shares, now discredited star analysts such as Jack Grubman and Mary Meeker appeared to gain the power to make or break a boss's career.

There used to be ways of finessing the gap between Wall Street's expectations and humdrum business reality. By taking big write-offs against profits (an acknowledgment that previously stated profits were too high), firms could periodically return their reported profits to reality. From the new low base, profits could then start to grow again at the required double-digit rate—until the next wave of write-offs became necessary. One such write-off wave happened at the beginning of the 1990s. A second is cresting now. Goldman Sachs guesses that write-offs will peak this year at the equivalent of 57.3% of the S&P 500's reported profits.

But Wall Street no longer wants to play these games—or no longer thinks it can get away with doing so. Scandals have shattered analysts' credibility. Now all the talk is of earnings “quality”—a euphemism for asking what accounting tricks firms employ to meet Wall Street's numbers. Instead of winking at firms' ever-more-generous definitions of “core” earnings, some analysts want to reverse the process, subtracting from profits such items as employee share options and properly accounted pensions costs.

Shareholders, meanwhile, have grown deeply suspicious. As companies such as General Electric have found to their cost, always making one's numbers no longer reaps a reward in the form of a higher share price. Instead, a firm obsessively trying to make its numbers is seen as suspicious, trying to cover up

A firm obsessively trying to make its numbers is seen

lousy management, perhaps, or maybe worse.

So why not come clean? This, alas, seems to do more harm than good. After its confession in January that it would not meet its growth targets, analysts now berate AOL Time Warner for destroying investor confidence. Along with Tyco and other fallen growth stocks, it has become a target of Wall Street and the media—viewed as unreliable and possibly in need of further management change.

as suspicious, trying to cover up lousy management, perhaps, or maybe worse

Despite their loss of reputation, analysts can still move share prices, at least in the short run. On September 27th, after two uncharitable research reports, GE's share price tumbled by more than 7%. Share options and the risk of being taken over make bosses sensitive to short-term movements in share prices. Analysts thus remain a vital constituency.

Its long-term profit outlook, not its ability to meet easily manipulated and largely meaningless quarterly numbers, ought to determine a company's market value. But how to give shareholders an accurate idea of the long-term outlook? Consulting firms such as Marakon and Monitor tell bosses to pick just a few yardsticks, such as likely future sales of a key product. They point admiringly to Microsoft's guidance last week that, over the next ten years, growth in sales of desktop software is likely to slow to about 7% a year.

The problem, says Joseph Fuller of Monitor, is that managers resist being pinned to such awkwardly concrete targets. The malleable language of earnings, notes Mr Fuller, “is convenient for both sides.” Still, judging by current events on Wall Street, share analysts may soon be a thing of the past, and with them will go corporate America's obsession with quarterly profits. Well, it's a nice idea.

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Phone scams

You've got my number

Oct 3rd 2002 | TOKYO
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Japanese mobile-phone users have a new reason not to call back

EPA

No, I don't want Wet and Windy

TAKE a national addiction to mobile phones, add caller-identification, and stir in natural curiosity. The result? Japan's latest scam, against which NTT, a big phone company, is battling valiantly.

Dubbed *wan giri*, or "one-ring hang-ups", the scheme targets millions of mobile-phone lovers. Unscrupulous operators make thousands of random calls from normal phone lines, letting the phones ring once before hanging up. They count on inquisitive folk, or those anxious not to miss a single call, ringing back the number shown on their screens. Those who do find themselves listening to advertisements for all sorts of dodgy services. Some firms try to hook callers into subscribing, say, to high-priced chat-lines or Internet services. Even if only a small fraction are snared, it is still a lucrative ploy: their own charges are small since they never give their quarry a chance to answer.

Others dupe callers into providing credit-card numbers. Using caller-identification in reverse helps to harass more users. Some victims decide it is easier to pay than face fresh hassles.

Wan giri made waves this summer after one firm jammed NTT's exchanges in Osaka, the second-largest city, for over four hours. Businesses suffered huge disruption when the firm used high-tech systems to make up to 3,100 calls a minute, swamping NTT with two-and-a-half times normal volumes.

A furious NTT soon found that making lots of phone calls is not against the law. So it added a clause to customer contracts warning that it would bar anybody making large numbers of calls that cut off before they were answered. That hampered some of the bigger *wan giri* operations, but failed to stop smaller ones. Anxious to protect consumers, the Ministry of Economics, Trade and Industry printed posters urging people to ignore *wan giri* calls or bogus bills, and to report any threats to the police.

NTT's new weapon, out this month, is a service allowing mobile-phone users to punch in the number of any *wan giri* callers. Once registered, a *wan giri* operator calling the number again is charged for calls that go unanswered.

Last week, NTT DoCoMo, a big mobile-phone operator, joined the fray with a new product that silences the first ring on incoming calls. Though handy, it is not foolproof. Caller-identification (a basic feature on Japanese mobile phones, but not on land-lines) still records the incoming call. And presumably, knowing the first ring will be ignored, the *wan giri* will now simply ring twice.

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Ford Motor

Rule Britannia

Oct 3rd 2002 | PARIS
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A stealthy British coup at the car giant

FORD'S share price is on the ropes and the debt markets are pummelling its bonds as the car maker struggles in a vicious price war started by General Motors. Yet Ford is at last recovering in Europe, after years of heavy losses. Visitors to the Paris motor show this week can see the latest weapons in its revival campaign, as Ford of Europe shows off six new models.

Ford's European profit is tiny, $155m in the second quarter. But that is three times its American profits in the same period. In Europe Ford is halfway through a three-year effort to cut annual costs by $3 billion. According to David Thursfield, chairman of Ford of Europe, capacity has been slashed, factories are 95% full and $2 billion will soon be sliced from its parts bill.

But the daunting challenge is in America, where Ford is still caught in the aftermath of the Firestone fiasco two years ago, when it had to recall millions of vehicles with faulty tyres. Added to low quality and botched product launches, that drove Ford deep into the red last year. It is no wonder that when Bill Ford, of the founding family, grabbed control of the firm last autumn from Jacques Nasser he began to surround himself with top British managers from Europe, hoping they could repeat their turnaround act in America.

There are few American firms in which foreigners, let alone Brits, hold so many top jobs. The chairman and two vice-chairmen are American. But day-to-day, Ford is run by an Englishman, Sir Nick Scheele, who made his name turning round Jaguar, Ford's upmarket British subsidiary. His number two in Detroit is now Mr Thursfield. Operational responsibility for Ford of Europe has now passed to another Englishman, Martin Leach.

A Welshman, Richard Parry-Jones, is group vice-president in charge of global product development. Working for him are English designers, such as Gerry McGovern at Ford's Lincoln division in California, and Peter Horbury, at Volvo, Land Rover and Jaguar. The new head of global marketing is another Jaguar graduate, Joe Greenwell from England's Midlands. Martin Inglis, yet another Brit (although now an American citizen) actually ran Ford North America, before becoming vice-president in charge of strategy.

Are things really so bad at Ford that they have let the British take charge? To be fair, this is not an entirely new phenomenon. The chairman before Bill Ford was Sir Alex (now Lord) Trotman, a Scot who spent his whole career with the firm.

Ironically, Ford may have been a direct beneficiary of the woeful state of British manufacturing in general, and its car industry in particular, in the 1960s and 1970s. Then, the few attractive workplaces for aspiring British industrialists were provided by foreign-owned car firms such as Ford, which also had its European head office in Britain. In those days Ford had a reputation for superior financial management as well as engineering. Bright young graduates—in the days before Europe had business schools—wanted to have Ford on their résumés. It also attracted talented refugees, such as Mr Thursfield, from the ailing domestic motor industry, above all the collapsing British Leyland.

Ford's diaspora has spread far and wide in British business. Lord Trotman is chairman of ICI, Britain's leading chemical firm. Ian McAllister, a former head of Ford Britain, chairs the firm that now owns Britain's rail network. Meanwhile, many of those who stayed on have risen to the top. If Mr Thursfield can help Sir Nick to repeat the European recovery in North America, he is tipped to take over the throne from Bill Ford in a couple of years.

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Business-to-business exchanges

Life after dotcom death

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If you think B2B marketplaces are dead, read on

REMEMBER Chemdex, the Silicon Valley start-up that led the craze surrounding business-to-business (B2B) marketplaces? After gaining almost 70% in its first day of public trading and reaching a market capitalisation of $11 billion early in 2000, within a year it had shut down its exchanges and started a second life as a B2B software company. In August 2001, it bought NexPrise, a software start-up, whose identity it has now assumed.

Most of the hundreds of B2B marketplaces that sprang up in the late 1990s failed to raise enough capital for a makeover and so simply closed. But contrary to conventional wisdom, not all of these exchanges are doomed. One of them, DoveBid, had even hoped to become the first initial public offering in America since July, though this week it pulled its plans indefinitely. Although the firm is losing money ($265,000 on revenues of $27.5m in the quarter ending in June), it may yet revive its planned sale and even prove, at least in the long term, a good investment. That is primarily because, unlike most dotcoms, it runs on a healthy mix of old and new economy.

As an auction house for surplus assets, DoveBid makes much of its money in one of the few lively markets in today's sluggish economy: selling off the remains of defunct companies, most recently those of Enron. The silver cockeyed E, which once stood proudly in front of the firm's headquarters in Houston, fetched $44,000.

More importantly, unlike most early B2B exchanges, the firm is not an upstart online marketplace that focuses solely on hammering suppliers on price. This is not surprising given the firm's longevity. Founded in 1937 as an auction house for used appliances, it first became well-known in the 1980s for selling the assets of an earlier generation of bankrupt Silicon Valley firms, such as Osborne Computer.

When DoveBid went online in 1999, it used the Internet not to replace but to improve its existing business. Although it now conducts online auctions, its more striking innovation was broadcasting live events on the web and allowing off-site participants to make bids in real-time. This attracted many new bidders, often from abroad—and drove up prices.

Having grown up in the old economy, DoveBid also has the know-how to offer all sorts of ancillary services, such as evaluating assets for buyers and helping them to work out how to ship heavy factory-equipment from, say, Chicago to Shanghai. Raising the cash to beef up these services, most likely through acquisitions, is said to be the main justification for the IPO (as well as the desire of venture capitalists for a return on the nearly $150m they invested in the firm).

To be sure, DoveBid still has much to prove—not least that it can make money. But it provides a reason for hope for those who think that independent B2B exchanges can be viable businesses alongside those B2B exchanges operated by industry consortia, such as Covisint, which trades supplies for car makers.

Instead of being mere trading systems, as the early B2B pioneers envisaged them, it is now clear that independent exchanges such as DoveBid depend crucially on deep industry knowledge and must add value with services that facilitate transactions, says Hal Varian of the School of Information Management and Systems at the University of California, Berkeley. Deep industry knowledge: whatever next?

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Chinese tourists

Follow the yellow umbrella

Oct 3rd 2002 | HONG KONG
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Millions already do, tens of millions soon will

MOST Chinese travel at least twice a year, during the two so-called “golden weeks” around lunar new year and national day on October 1st. Most still stay inside China. But more and more are venturing abroad in packaged-tour groups. So they did again this week.

Their numbers are startling. Last year, 4m Chinese travelled abroad. By 2005, it might be 16m, reckons Andy Xie, an economist at Morgan Stanley in Hong Kong. By 2020, according to the World Tourism Organisation, the number could be 100m. Yes, the Chinese are expected to replace the Americans, Japanese and Germans as the world's top travellers.

The tourist industries in their favoured destinations—at present Thailand, Australia and Turkey—welcome them with open arms, even if the general population is not always so thrilled. That is because the invariably wealthy Chinese tourists spend more than their counterparts from elsewhere. In Singapore, for instance, they spend nearly twice as much per head as the Japanese. In Hong Kong, mainlanders already account for some 47% of all tourist spending and 8% of all retail sales.

In South-East Asia, Chinese tourism is fast becoming a major contributor to economic growth. Indeed, boosting it is increasingly seen as a matter of survival. Paranoid theories abound about South-East Asia losing manufacturing to a rising China boasting much cheaper labour. So many economists now argue that South-East Asia's future comparative advantage will lie in supplying tourist services to the swelling ranks of China's affluent.

Some countries are going out of their way to lure the Chinese hordes. Singapore and Malaysia have declared ambitions to welcome at least 1m Chinese next year. Singapore has negotiated more flights to more cities, both in booming coastal areas and in inland centres such as Chengdu.

Meanwhile, western countries such as Canada, Finland and Switzerland are looking into ways to make it easier for the Chinese to get tourist visas. The main worry is that “tourists” might overstay or claim refugee status on arrival. So these countries are negotiating with China's government to join Australia, New Zealand, Germany, Turkey, Hong Kong, and most of South-East Asia in getting Approved Destination Status (ADS). Under ADS, Beijing sets outbound quotas for package tours organised by state-owned travel agencies, whose function is to ensure that nobody in their groups absconds. Last month, Beijing licensed 461 new agencies, on top of the mere 67 that were previously offering such holidays—just in time for this year's rush.

The Chinese are leaving their mark on places. Macau rarely brags any more about its hidden Portuguese façades, but talks instead about turning its casino industry, Asia's biggest, into a Las Vegas for mainlanders—complete with a spewing plastic volcano in the harbour. Hong Kong's hopes are hitched to a forthcoming theme park by Disney. And Thailand's girlie bars will never be the same again.

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AIDS and South African business

Strategic caring

Oct 3rd 2002 | JOHANNESBURG
From The Economist print edition

Firms strategise about AIDS

GREATER transparency for American firms may mean little more than describing what outlandish perks the boss gets. In South Africa, the disclosures will make much grimmer reading. Johannesburg's stock exchange is currently “considering what form of accounting standard is needed from listed companies”. Translated: in six months, firms listed on the exchange will probably be required to publish anti-AIDS policies. Before long, they will have to spell out how AIDS affects their business, markets and workers, and show how they are fighting it.

Elsewhere, say in America, such requirements would probably be seen as a triumph by the “corporate responsibility” movement, and as a burden by firms and investors. In South Africa, at least some of the demand for disclosure has come from investors, and many corporate bosses have long been planning anti-AIDS strategies in part because it has become impossible to make informed decisions without considering the impact of the disease.

Investors are worried that firms are keeping quiet about what AIDS will do to their business, and thus their value. Earlier this year, the King report, a widely welcomed study on corporate governance, called on firms to disclose their exposure to AIDS—there are now 5m people in South Africa infected with HIV and many more in other parts of Africa where South African firms operate.

A survey by Deloitte and Touche earlier this year found that roughly half of South Africa's bigger firms had adopted a formal HIV/AIDS policy. In the past three months several mining companies, including Anglo American, AngloGold and De Beers, have announced that they would give infected workers free anti-retroviral drugs. Tens of thousands of workers are likely to take up the offer. On September 10th, Old Mutual, a finance firm, followed suit for the 5% of its workforce it says are infected. DaimlerChrysler and Transnet, a transport utility, have made similar promises. On September 26th Coca-Cola's Africa Foundation said it would roll out an anti-AIDS medical programme, including some drugs, for 40 bottling firms in Africa.

As the number of people with full-blown AIDS soars, firms are beginning to see a loss of productivity, low morale, absenteeism, and the death of workers aged between 20 and 40. As skilled and experienced workers die, their firms face rising retraining costs and the loss of valuable know-how, as well as the need to deal with grief-stricken colleagues. Even for unskilled workers, there are extra hiring costs and sick-leave payments. AngloGold, for example, estimates that the virus adds as much as $6 to the $170-180 cost of producing an ounce of gold.

Providing drugs, educating workers and treating infections may sometimes be a firm's cheapest option. “It now costs more not to treat than to treat,” argues Clem Sunter, a business analyst who studies the impact of AIDS. Yet many smaller firms are likely to decide it is too costly to help workers, beyond paying for any basic medical insurance that is available.

“It now costs more not to treat than to treat”

Big company bosses are also acutely aware that being seen to do something about AIDS may transform their corporate image, especially with foreign investors. South African executives travelling abroad find any conversation turns quickly to the AIDS problem, and the uselessness of the South African government's response to it. South Africa has more people infected with HIV than any other country, but the government is loth to dispense anti-AIDS drugs at state hospitals. Notoriously, President Thabo Mbeki doubts their usefulness and safety and fears the cost. Given that, foreign investors ask, why doesn't the boss do something through the firm? Now, many are.

The danger is that politicians will simply try to shift the burden of tackling AIDS on to the corporate sector. On September 28th, ex-president Nelson Mandela praised those firms with AIDS plans, before saying that “there can be no excuse for a South African corporation not to be at the forefront of the battle against HIV/AIDS by making anti-retroviral drugs available to your staff”.

Clearly, the long-term interest of most firms is for South Africa to have as many workers and consumers as possible. But investing in long-term population management does not make sense for a lone firm, given the large up-front costs and highly uncertain long-term benefits. This is the sort of investment decision that only a government is properly equipped to take.

True, firms can work in partnership with government, so long as their costs are not excessive. This makes particular sense when a company dominates a local community, as De Beers does Kimberley and DaimlerChrysler East London. In a 1996 experiment in Virginia, the local mining firm offered staff and the public, especially sex-workers, medical care (notably for sexually transmitted diseases); the spread of HIV slowed sharply. This cost 270,000 rand ($63,000), but stopped perhaps 285 people catching the disease—cheaper than treating them later.

Yet in South Africa, for all their current goodwill, firms are increasingly facing a fight against AIDS on two fronts: the effort to withstand attempts by the government to make them responsible for fighting AIDS in the population at large—and their own struggle to care for their workers.

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Face value

Le capitalisme sauvage

Oct 3rd 2002
From The Economist print edition

Will the new faces of French capitalism, such as Thierry Breton, fare any better than the old?

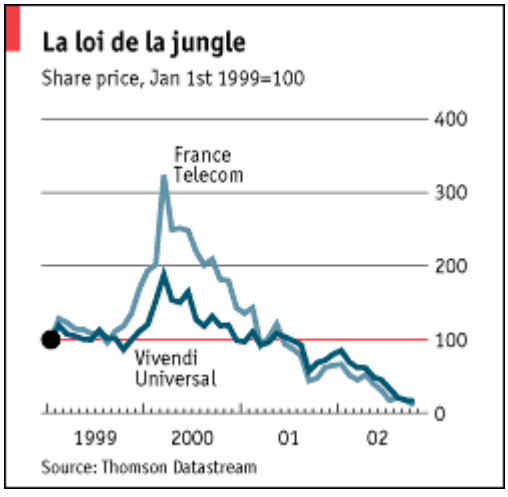
EUROPEANS, it is fair to say, have taken a certain pleasure in the rash of corporate disasters in America. Indeed, after years of being lectured by the Yanks and Brits about the superiority of what the French call *le capitalisme sauvage du modèle anglo-saxon*, a little *Schadenfreude* may be in order. Yet it would be wrong to conclude that Europeans are any less prone to corporate trouble. Look no further than Vivendi Universal and France Telecom, two humbled giants now testing France's brand of capitalism to its limits.

Both firms are struggling with problems caused by the flawed strategies of high-profile bosses who have recently resigned. And both firms have new bosses—Thierry Breton was chosen this week to head France Telecom—whose mission is to restore faith in the judgment of the business and financial elite that runs France, an elite that was instrumental behind the scenes in ousting the old bosses and choosing the new ones. It was this same elite that had watched jealously as Jean-Marie Messier expanded Vivendi from a stolid utility into a bloated media group, and that did nothing as Michel Bon turned France Telecom into the world's most indebted public company.

The era of Messrs Messier and Bon in the late 1990s had seemed to signal a new phase in France's complex relationship with capitalism. Wary of the stockmarket-centric Anglo-American model, and its *loi de la jungle*, France had kept a firm central grip on large swathes of its economy. As Vivendi and others began to thrive (apparently) on a global stage, that grip relaxed. Although it remained majority state-owned, France Telecom was allowed to expand headlong outside France, fatally using cash for deals so as not to dilute the state's equity stake.

This newer form of capitalism may have been controversial, but it took root. The stockmarket boomed. More French bosses were awarded stock options. Although plenty of entrepreneurial French youngsters still chose to live in London, with its lighter taxes and regulation, more decided to try their luck at home.

Now the mood has altered again. At the heart of traditional French capitalism was a belief that the state, embodied by France's top politicians, financiers and business leaders, should be the ultimate arbiter of important economic questions. The Messier and Bon fiascos have given renewed strength to supporters of that old model. First, this led to the brutal ejection of the discredited bosses. More subtly, it meant appointing replacements who can be expected not to cause the elite further embarrassment.



Plus ça change?

What difference will new men such as Mr Breton make? Will the recent pro-market move be reversed, or will the French elite find that it cannot force the *laisser-faire* genie entirely back in its bottle?

Nobody will experience the struggle between old and new French capitalism more intensely than Mr Breton, nor do more to shape the outcome. After all, the state's role in France Telecom is explicit, through its shares. That ensures it will not go bust—which cannot be said of, say, Vivendi; but it also means Mr Breton will have to devote much of his energy to retaining the backing of the government, which is still arguing about how French capitalism should evolve.

Famous for his big hair and a youthful degree of flamboyance—he is a mere 47 years old—Mr Breton is nonetheless regarded by the elite as having the right sort of flair (unlike, say, the famously ego-centric Mr Messier). Most observers credit him with reviving Thomson Multimedia, an electronics group that was at death's door when he became its boss five years ago. He took it public in 1999. (Never mind that Bull, the computer firm he helped run prior to Thomson, is a mess.)

Yet he has his work cut out. With over *euro*70 billion ($69 billion) of debts, France Telecom needs radical financial restructuring, as well as tough operational measures to boost efficiency. That should mean huge job cuts by one of France's largest employers. Mr Breton is said to have negotiated the right to make lay-offs of part-timers before taking the job, but that will not be enough. And as France Telecom is constantly in the public eye, his every move will become a political issue.

What attention will Mr Breton pay to the markets? Traditionally, the elite have made decisions secretively and been loth to explain them, least of all to traders. If Mr Breton plans to use this *ancien* communication strategy, he should note the fate of his fellow boss, Jean-René Fourtou, Mr Messier's successor at Vivendi.

A former head of Aventis, a drug company, Mr Fourtou is an old establishment hand. Last week he unveiled his plans to save the media conglomerate. With each day that passes, investors become less convinced that what he told them was full and frank. For instance, he said that Vivendi had off-loaded Telepiu, its cash-hungry, loss-making Italian pay-TV business. Alas, it turned out that a deal had not been done. The putative buyer, Rupert Murdoch, quickly put the record straight, forcing Mr Fourtou to backtrack and causing Vivendi's shares to plunge—before the deal was finally completed on October 1st.

Mr Breton is to announce his rescue plan for France Telecom in two months' time. He should remember that such, ahem, imprecision can fatally undermine an already difficult turnaround. Nor should this be forgotten by the elite. It is one thing to intervene and install new managers, quite another to think that they can somehow buck the markets. Investors will stick with a France Telecom or a Vivendi only if they trust its bosses to spell out clearly how they are proceeding—and to do what the markets want. If not, they can take their money elsewhere. In the end, the shape of French capitalism may depend on whether Mr Breton's elite state bosses can bring themselves to care about what his other masters in the markets think. *Bonne chance!*

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Investment banking under fire

Capitulate or die

Oct 3rd 2002 | NEW YORK AND WASHINGTON, DC
From The Economist print edition

Ronald Grant

Terrified by the threat of litigation, investment banks may be forced to transform themselves

THE question is no longer whether, but how, Wall Street will change. Merely keeping track of the investigations about Enron, WorldCom, initial public offerings (IPOs), and research analysts' conflicts of interest is a daunting task. Besides scrutiny by the Securities and Exchange Commission (at least two big firms were called in by the SEC for private discussions in the past week), state regulators are also crawling over the banks. So is the Justice Department. And Congress. Two self-regulatory organisations, the New York Stock Exchange and the National Association of Securities Dealers, may also push for disciplinary action.

Perhaps curiously, Congress is the only body not seeking actively to reregulate Wall Street. This week Michael Oxley, Republican chairman of the House committee on financial services, was in New York telling a gathering of company directors that the Sarbanes-Oxley act on corporate governance, passed in late July, would be the last legislation for some time (though he also suggests that some aspects of the regulatory structure, notably the supervision of derivatives trading and insurance, may be re-examined). Senator Paul Sarbanes also promises that there will be no new laws; he would prefer to see his eponymous act properly implemented first, including its controversial application to foreign firms listed on American stock exchanges.

Yet even as Mr Oxley was speaking to a thin crowd, New York state's attorney-general, Eliot Spitzer, had a standing-room-only audience as he accused the Salomon Smith Barney subsidiary of Citigroup, America's biggest bank, of bribery. He vowed to change the rules of finance. It is he, not Messrs Oxley or Sarbanes, or even Harvey Pitt, the SEC's chairman, who is the man of the moment.

Mr Spitzer's crusading zeal has got regulators from 40 states thinking. Traditionally, they would investigate only local problems; now they have divvied up the big Wall Street firms. Alabama is in charge of investigating Lehman Brothers. Bear Stearns is being probed by New Jersey. Texas gets J.P. Morgan Chase, California Deutsche Bank, and UBS Warburg goes to Connecticut, Arizona and Florida.

Massachusetts, which drew CSFB, was first to threaten a charge. On September 19th William Galvin, the state's chief securities regulator, accused the bank of slanting its research in favour of investment-banking clients. Mr Galvin urged criminal charges; because he has no power to press them, he shipped the case back to Mr Spitzer, who does. On September 30th Utah's chief securities regulator, Anthony Taggart, said that Goldman Sachs, which has fallen to him, had “better be careful about engaging in settlement talks without taking us into

“I wonder of what use bankers are if all they can depend on to get business is

account. A settlement may or may not make us go away." Congressional investigators are looking into how Goldman gave shares in hot IPOs to top executives at 21 companies, including eBay and Yahoo!

analysts who recommend their banking clients"

Although it is not clear that it has any sway over all this litigation, the SEC is quietly pushing for a more comprehensive plan. All the investigations, stretching across states, federal regulators and the stock exchanges, should be settled all at once. Any restructuring of firms, particularly over the role of equity analysts, would apply not to one, but to all—regardless of whether they are being investigated. To answer objections to Merrill Lynch's settlement in May with Mr Spitzer, which saw half the $100m fine going to New York state and half to the other 49 states, all fines would go to a restitution fund, overseen by a court.

Getting the various regulators to agree to this will be a formidable task for the SEC, particularly when so many are enjoying the limelight. The pressure for a really dramatic resolution has grown. The SEC is now actively considering forcing a separation of research from investment banking. It is not clear how such a separation might work without a total dismemberment of the big firms. But if they have raised objections, they have done so only privately.

And probably not by e-mail. The complaint that Mr Spitzer filed with the Supreme Court of New York on September 30th covered five former executives of bankrupt or troubled telecoms firms who are accused of giving Citigroup investment-banking business in exchange for lucrative allocations in public offerings. They are all well-known: Bernie Ebbers of WorldCom, Philip Anschutz and Joe Nacchio of Qwest, Stephen Garofalo of Metromedia and Clark McLeod of McLeod USA. Collectively, they are said to have earned $28m from the sale of these IPO shares, while their companies paid Citi $277m in investment-banking fees. At the very least, Mr Spitzer argues, any inducement should have benefited the companies, not the executives. He wants the return of all profits from the share allocations, as well as the $1.7 billion these men apparently got from selling shares in their own companies.

The bulk of the complaint, however, has nothing to do with these deals, and everything to do with how Citigroup managed its investment research, described by the head of the bank's retail sales as "basically worthless". Analysts' pay was geared towards promoting investment banking, not helping investors. In a "best practices seminar", analysts were taught to support Citi's underwriting by providing companies that had just gone public with estimates of earnings so low that the companies could easily exceed them in the following two quarters.

For the first time, the complaint publicly lays out a case against Jack Grubman. He was once Citigroup's top telecoms analyst, but has since become an emblem of the stockmarket bubble. Between 1998 and 2001, Mr Grubman earned an average of $20m a year, according to the complaint. Much of this was down to the role he played securing investment-banking business for Citi—a consequence, in turn, of his view that "what used to be a conflict is now a synergy."

Although Citigroup's management almost certainly endorsed this view, Mr Grubman's behaviour riled his broking colleagues. Their e-mails are scathing about how Mr Grubman kept upbeat recommendations on a number of Citi's telecoms clients, even as their prospects worsened. He is described by Citigroup brokers as "an absolute disgrace" and "an investment-bank whore."

An e-mail by Mr Grubman to the head of research suggests that he understood the deteriorating conditions of the companies he recommended, but could not resist the investment-banking pressure. "I wonder of what use bankers are if all they can depend on to get business is analysts who recommend their banking clients." His legacy may be to force Wall Street to confront just this question.

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Wall Street dining

George's is dead

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From The Economist print edition

Long live George's

LAST weekend, on the corner of Greenwich and Rector Streets, four blocks south of the vast pit that once held the World Trade Centre, cracks appeared in the foundation of an old two-storey building. The ground floor had long been occupied by a modest diner named George's. It stood beside subway tracks damaged in the World Trade Centre's collapse, and recently there were extensive excavations to allow for repairs, causing noticeable vibrations.

When the cracks appeared, the city government moved swiftly to prevent a disaster, and prescribed demolition. Now there is another gaping hole in the neighbourhood—and a sad string of former customers visiting the remains.

The owner, George Koulmentas, only the latest in a series of owners called George, had run the restaurant for 22 years. The clientele was broad, including beggars, bankers, and children from a nearby day-care centre at Trinity Church. The kids' favourite tipple was egg cream—a foamy soda drink made from neither eggs nor cream.

During the day, traders from the American Stock Exchange slipped over for private chats. In the early evening it was a popular haunt of Wall Streeters taking a break from alcohol. It even used to be open all night, drawing in janitors and overworked investment analysts, until the shock of September 11th thinned out its client base. There were times when not a single person, including George, spoke English. George would address his staff in Greek, who would then speak to each other in Spanish.

Mr Koulmentas, after years of paying rent, had bought the building only two weeks ago. On Monday, standing by the wreckage, he promised reporters that a new and better diner would rise from the rubble.

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Bank regulation

Too nice in Basel

Oct 3rd 2002
From The Economist print edition

Regulators are shaping their rules to fit a discredited big-bank model

EVEN as big investment banks recoil from slavering watchdogs in America, they are getting much kinder treatment—perhaps too kind—from financial regulators in Basel and Brussels. This week the Basel committee of rich-country bank supervisors gave the fullest picture yet of how its new risk-based regime for banks will look. Although the regime, called Basel 2, will not come into force until January 2007 at the earliest, it seems already to be having a big impact on bank behaviour.

Since banks know that certain credit and operational risks will need a bigger buffer of regulatory capital, they are already cutting loans to riskier borrowers. And they are doing more trading through clearing-houses and exchanges—which reduces both operational and counterparty risk. Yet it still looks like a case of big banks pulling the regulators by the nose.

Basel 2 favours large banks that have good internal communications and are skilled at intermediating risks and unloading them on to others. Funnily enough, these are the same skills and the same banks that are getting such stick from American regulators and are under some threat of being broken up.

Bank regulators have certainly gone to great lengths to accommodate the methods that big banks have developed to judge their risks and conduct business. Yet, as Avinash Persaud at State Street, an American bank, points out, banks have a poor record of judging risk through business cycles—running blindly into property and technology booms and busts, for instance. Basel 2 risks making banks even more likely to accentuate business cycles, he says, since their allocations of regulatory capital will be even more finely tuned to their daily exposure to risk. The Basel committee's latest paper tries to respond to this worry by making the capital ratios less sensitive to business cycles, and by making room for a capital buffer against so-called pro-cyclicality, all at the discretion of supervisors.

Huw van Steenis at Morgan Stanley believes that the market downturn is already rendering some bits of financial regulation less relevant. For example, a debate has been raging in Europe over whether financial institutions may “internalise”, that is, match in-house trades by their clients of exchange-listed securities. The perceived danger is that the pricing of these trades is opaque and that the market is deprived of liquidity.

The European Commission's latest draft of its Investment Services Directive, circulated last month, requires institutions in the European Union to obtain a client's permission for an internalised trade and to report the price of the deal to the exchange. That could reduce the incentive to internalise, since transparency tends to eat into margins, says Mr van Steenis. Moreover, with lower trading volumes, institutions are in less hurry to invest in technology to internalise trades. Either way, this works in favour of the bigger banks with economies of scale and better systems.

Another study published this week by a consortium of finance-industry associations—dominated by the same big banks—comes out, unsurprisingly, in favour of internalisation*. Transparency can be taken too far, it argues, to the point where dealers will not deal. Moreover, internalisation promotes competition among the banks, electronic trading platforms and quasi-monopolistic exchanges.

However, a landscape in which regulators work hand-in-hand with the most powerful financial institutions to reinforce conditions under which only they thrive may not be the healthiest outcome. Bank regulators congratulate themselves that in this downturn the banks have (so far) proved well-capitalised. Banks have taken hits on their loan portfolios, but no major bank, it appears, has yet got into difficulty. Banks have learned to shunt their credit exposures elsewhere in the system—mostly, it is thought, to insurance companies and mutual funds.

There may be perverse consequences if it is not banks but insurers and mutual-fund investors who bear the brunt of financial pain. Banks were once expected to provide a buffer against economic cycles. The Basel committee would like that role to survive, yet the new regime is more likely to undermine it. What is more, regulators, such as Britain's Financial Services Authority, threaten to subject insurance companies to a similar regime. In other words, insurers, whose strength has lain in their ability to spread losses over long periods, may end up with their insurance assets and liabilities constantly marked to market.

Where, then, should financial risks properly reside, and what should regulators do to get them there? Probably not in giant investment-banking conglomerates, whose fortunes are subject to severe swings caused not only by market movements, and by operational risks, but also by assaults on their reputation. Reputation risk, incidentally, is more-or-less ignored by Basel 2.

The repute and trustworthiness of financial institutions is perhaps the biggest uncertainty in today's financial markets. A complex financial regime such as Basel 2, and financial regulations such as the EU's Investment Services Directive, appear to be designed not so much to serve users of financial services as to prolong the survival of institutions and ways of doing business that are no longer trusted by the public. The regulators in Basel and Brussels might bear that in mind.

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*"Capital Markets that Benefit Investors", by Ruben Lee. Oxford Finance Group, September 2002

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Bank reform in Japan

The Takenaka challenge

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From The Economist print edition

A new regulator, but will he wield a new broom?

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EPA

What's Takenaka going to pull out?

IS THIS the start of genuine reform, or a bad-dream repeat of 1998-99, when hopes were also raised only to be dashed? The prime minister's dismissal on September 30th of Hakuo Yanagisawa, the minister who was supposed to be sorting out Japan's rotten banks, surprised many. The move, the main feature of Junichiro Koizumi's first cabinet reshuffle since he took office last year, seems to offer a chance to speed up bank reform.

The new man, Heizo Takenaka, an academic who adds the financial-affairs post to his existing job of economy minister, has long been critical of his predecessor, insisting that the banks were in worse shape than Mr Yanagisawa claimed, and in need of more drastic reform. To that end, he suggests, unlike Mr Yanagisawa, that he is willing to use public funds to help banks offload their bad loans, which may amount to as much as ¥150 trillion ($1.2 trillion). Presumably, some banks would also temporarily be nationalised. Ironically, that is pretty much what Mr Yanagisawa did during a first stint as financial-affairs minister: in 1998 he won praise for overseeing the nationalisation of two big banks and injecting public money into another 16. Four years on, though, the banks are in worse shape than ever.

How can Mr Takenaka avoid the same fate, while helping Mr Koizumi to deliver on his new promise to make banks healthy by March 2005? Two paths for bank reform are under discussion. The first is to strengthen the Resolution and Collection Corporation (RCC), the state's loan-collection agency, as a way to provide a backdoor injection of public money. Proponents hope that getting the RCC to make more attractive bids for bad assets, through some sort of loss-sharing scheme between taxpayers and banks, will speed up the disposal of bad loans.

The second, more transparent approach requires regulators to use stricter rules to reclassify banks' non-performing loans. This will almost certainly reveal that banks are badly under-provisioned—and under-capitalised—and in need of public funds to fill the holes.

Before his appointment, Mr Takenaka was a loud critic of the first scheme, arguing that it would create considerable moral hazard. Banks would not be forced to change their ways, because they would not have to stop making fresh loans, or forgive old ones, for dud borrowers. That the new minister also wants first to figure out how weak the banks actually are suggests he will prefer the second approach.

He faces battles ahead. Morgan Stanley's chief economist in Japan, Robert Feldman, believes that banks need two or three times their current loan-loss reserves, or an extra ¥25 trillion, to be adequately provisioned. Koyo Ozeki, a credit analyst at Merrill Lynch, puts the hole at closer to ¥40 trillion-50 trillion.

Either way, banks will need a lot of public money. Deferred taxes, which will not materialise unless banks start making profits, make up about half of big banks' ¥17 trillion of tier-one capital. On September 30th, banks had unrealised equity losses of about ¥3 trillion-4 trillion. Subtract these and public funds that they must repay, and banks have little capital left.

Admitting that banks need help is one thing; acting swiftly to restore confidence in them quite another. The prospect of funds being taken from the public purse could quickly push down government-bond

prices, damaging banks' big bond portfolios. Stockmarkets might also fall, denting banks' equity holdings further. On October 2nd news that Takeshi Kimura, the head of KPMG Financial in Japan and a keen reformer, was being asked to serve on a special task-force on bank reform helped to send shares to fresh 19-year lows. The fear was of lots of bankruptcies in weak industries.

That prospect, and the threat of rising unemployment, frightens politicians. For every non-performing loan, there is a non-performing borrower—many of whom are big supporters of politicians in the ruling Liberal Democratic party (LDP). Yet Mr Takenaka will need political support to get reforms implemented.

Mr Takenaka, who has little experience with bureaucrats, is bound to face tussles with the Financial Services Agency (FSA) that he now heads. He will need its support to deal with the practical aspects of reform. Take public funds. According to the FSA, the government may no longer forcibly inject the ¥15 trillion of emergency public funds now available into banks that are not yet insolvent. But a voluntary scheme is unlikely to work either, says Brian Waterhouse, a bank analyst at HSBC Securities in Tokyo. Banks do not want to be branded as weak. To force banks to accept tough conditions in return for money, Mr Takenaka would need to revise current laws, a process that is bound to be both complex and lengthy.

Temporarily nationalising even a handful of banks, and cleaning them up, would be no easier. Since banks lend, more-or-less, to the same borrowers, forcing dud companies into bankruptcy as part of a clean-up of bad loans would probably tip other banks into insolvency as well. This knock-on effect could mean that most of the big banks end up nationalised.

This is probably what bank reform should actually entail. Yet there are doubts that Mr Koizumi and Mr Takenaka will be prepared to go that far. Even if they are, they may not be able to persuade politicians, bureaucrats and the public to support them. That Mr Takenaka is already considering delaying deposit-insurance reform has delighted the LDP's old guard.

If Mr Takenaka settles for half-measures, he will repeat the mistakes made in 1998-99. Only this time, warns Mr Ozeki, stockmarkets are lower, companies are weaker, public debt is bigger and the world economy is in worse shape. Not only might that mean a waste of more money; but things would also get much worse, quicker.

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IMF/World Bank meetings

Battling over the bankrupt

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From The Economist print edition

Politicians and bankers are at loggerheads over insolvent countries

Get article background

OFFICIALLY the world last week came closer to creating a better system for dealing with countries that go bust. At the annual meetings of the International Monetary Fund and World Bank, finance ministers pushed two, supposedly complementary, reform ideas a few steps forward. First, they gave the IMF six months to come up with a proposal for how to craft a statutory framework for bankruptcy, by amending the Fund's articles of agreement (a plan known as the Sovereign Debt Restructuring Mechanism, or SDRM). Second, they claimed progress in dealing with defaults on a voluntary basis, by encouraging emerging economies and their financiers to include “collective-action clauses” in sovereign-bond contracts.

In reality, efforts to reform sovereign bankruptcy are a mess. Nobody knows if rich countries, particularly the United States, are willing to change international law—or if they are merely using the SDRM threat to corral investors and emerging-market countries into accepting collective-action clauses. Financiers involved in emerging markets loathe the SDRM, although few of them appear to understand it properly. Many have threatened to stop co-operating on collective-action clauses until the “nuclear weapon” of the SDRM is disarmed.

Emerging markets themselves are terrified of any change that would further increase the cost of their debt. Mexico's finance minister, Francisco Gil Diaz, flatly contradicted the rich countries last weekend. He pointed out that Mexico had not included collective-action clauses in its latest bond issue on September 17th, and added: “Nor do we plan to.” With tempers short, the risk is that nothing happens on either reform proposal.

That would be a pity. In principle, there is a strong case for improving the process for dealing with insolvent countries, just as bankruptcy laws provide a framework for dealing with firms that go bust. Argentina, for instance, has over 80 different bond issues outstanding, as well as other kinds of debt. Many bonds are issued under New York law, which means that any individual bondholder has the right to sue and demand full payment. A procedure that ensured collective action among these many and varied creditors would be good.

The problem is how to do it. The IMF's initial proposal, last November, put the Fund centre-stage in a kind of bankruptcy court. After bankers and politicians complained that this idea gave the IMF too much power, the Fund proposed a more modest, creditor-driven, version: a supermajority of creditors would decide the terms of a restructuring; officially, the IMF would have no new power. Nonetheless, the SDRM would imply a big shift. The new rules would apply immediately to all external sovereign debt. Votes for a restructuring could be aggregated across different kinds of debt. And there would be a new international forum for resolving disputes. There would, in short, be a clearly defined process for dealing with sovereign default.

Yet the bankers remain appalled. They claim that the SDRM would expropriate the rights of existing bondholders. They say it would make default easier and, whatever the Fund's official line, would increase the power of an institution that is driven by politics more than economics. Many bankers see the SDRM as part of a plot to phase out IMF lending. Others note that the IMF is itself often a big creditor and would have conflicts of interest.

The chances of America's Congress agreeing to such a change in the Fund's rules are slim. That is why America's Treasury insisted on pushing a second, market-based, approach. In April, John Taylor, top

international man in the Treasury, proposed a souped-up version of the collective-action clauses that are common in bonds issued under English law. On top of the clause that allows a majority of a bond's holders to approve a restructuring, he wanted other clauses that lay out the procedures for initiating and managing a default. If all countries introduced these clauses in all debt, Mr Taylor's scheme would look very much like the SDRM.

Over the past six months his ideas have been scaled back. A working group organised by the G10 group of rich countries has come up with model collective-action clauses that are, in many ways, weaker than those that already exist under English law. Meanwhile, some private-sector groups are working on their own sets of (weak) collective-action clauses. Mr Taylor's plan is to get agreement on these clauses, and to get emerging-market governments to introduce them soon. Existing bonds without clauses, he suggests, could be swapped for new debt with clauses.

Yet collective-action clauses will not make much difference to the way debt defaults are actually handled. They make it marginally easier to restructure an individual bond, but make little difference when there are 80 different bonds involved. Worse, few debt crises are purely about external sovereign bonds. Asia's financial crisis was all about firms' and banks' foreign debts; Brazil's problems are mainly to do with domestic debt.

The SDRM, by contrast, would change the way emerging-market defaults are handled. Although it would not formally include domestic debt, most advocates reckon that any country using the SDRM would have to restructure domestic debt, too. Most important, by changing international law, politicians would send a strong signal that they were serious about creating a procedure to deal with default. The problem is that neither creditors nor debtors seem to be able to agree.

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European insurers

Capital concerns

Oct 3rd 2002
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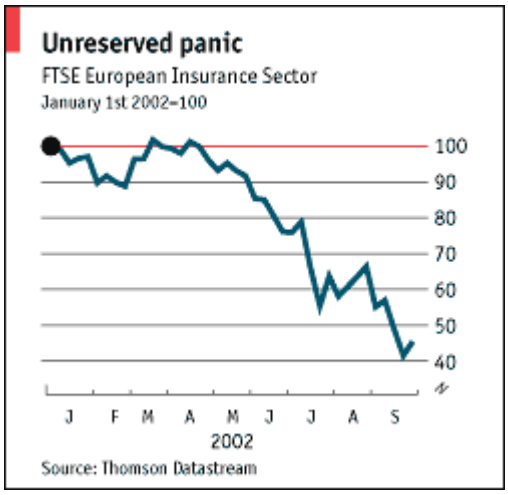
The stockmarket gets insurers down. And vice versa

A SEEMINGLY never-ending stream of problems for European insurers: if it is not a new cash call for an insurer, or an emergency injection of capital from a parent, it is a sudden plunge in an insurance company's share price. On September 30th Scor, a French reinsurer, announced a *euro*400m ($395m) share issue, joining a long queue of cash calls—from Legal & General, Aegon, Swiss Life, Zurich Financial Services and Hiscox, among others. On October 2nd Credit Suisse said it would pump a further SFr 2 billion ($1.35 billion) into Winterthur, after injecting SFr1.7 billion into its shaky insurance subsidiary in June. This week European insurance shares plunged to new lows. Since the start of the year, they have lost three-fifths of their value (see chart), against a fall of a third in the market as a whole.

Insurers are particularly vulnerable to falls in equity markets, because they invest heavily in shares. Even though they have cut back on their equity holdings, European insurers still hold 30% of their assets in equities, compared with only 4% for American insurers, according to Morgan Stanley—though the European average falls by eight points if British insurers are excluded. Insurers used to tolerate losses on their underwriting business because healthy investment returns more than made up for them. The average combined ratio (ie, claims plus expenses divided by premiums) is 105% for European non-life insurers, and a bit over 100% for life insurers. Investment returns matter, therefore.



Catastrophe losses and rising long-term liabilities have added to insurers' problems. Last year was the worst ever for property-and-casualty insurance. The attacks of September 11th caused the highest insured losses in history, but losses from natural catastrophes were also high. And that is before taking into account rising claims for asbestos-related illnesses.

A number of European insurers are so short of capital that they cannot underwrite new business. A few are almost broke, unable to meet immediate liabilities without a cash injection or a rights issue. Life insurers are more fragile than non-life insurers; they have tended to invest more heavily in equities. They also tend to lock into long-term contracts and so cannot increase prices each year. What is more, their new business suffers when stockmarkets are tumbling. Equitable Life in Britain and Swiss Life, Switzerland's biggest life insurer, are among firms in critical condition. Equitable has closed for new business; it has imposed hefty penalties on policyholders who try to cash out early; and it has sold £2 billion ($3 billion) of equities since June, to meet solvency requirements. Swiss Life has this year booted out its chief executive, made a cash call for SFr 1.2 billion, cut 1,500 jobs and announced the sale of non-core businesses—and still that may not be enough.

Making matters worse, life insurers in Switzerland and Germany are required by law to provide a minimum annual return to policyholders. Regulators have been easing these rules. In June 2000 German regulators cut the required return, from 4% to 3.25%, and they may well cut it further. Switzerland envisages a similar reduction, though politicians strongly oppose this.

Non-life insurers are in slightly better shape. They, too, invest in equities, but at least they can raise prices of their insurance products. In the past year premiums for all types of property-and-casualty policies have rocketed, in some cases as much as three- or fourfold; they show no sign of letting up. For instance, on October 1st ThyssenKrupp, a German steel conglomerate, agreed to pay 60% more, for less

cover, when it renewed its insurance contract for next year.

Debt instruments as well as equities are a headache for both life and non-life insurers. When they still had pots of cash, insurers bought credit risk, in the shape of corporate bonds or credit derivatives. Since then, Aegon has lost $200m thanks to the collapse of WorldCom. Britain's Prudential lost $230m on its American portfolio of corporate bonds in the first half of this year. Insurers' losses from credit derivatives are trickier to pin down. It is, notes Robert Procter at Morgan Stanley, extremely hard to find out which insurers hold such derivatives.

Though only a handful of insurers are heading for insolvency, European insurance will look very different in a few years' time. Insurance is much more fragmented than, say, banking. Germany, for example, has more than 150 insurance companies, but that number may shrink sharply, as stronger insurers take over weak ones. The regulation of insurers might also change. Now that regulation has been harmonised through a series of European directives, insurers have an EU-wide “passport” to sell policies in any member country. Still, countries continue to set their own rules for minimum returns from life-insurance policies, solvency requirements, limits on equity investment, and so on. Over time, expect a convergence.

Insurance shares are justifiably low, says Mr Procter. European insurers need to make profits from underwriting, to invest less riskily (meaning less in equities), and to bring down the costs of selling policies before investors regain faith in their business model.

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Banking secrecy

Squeezing the gnomes

Oct 3rd 2002 | BRUSSELS
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A growing spat between the EU and the Swiss

FOR a small country, Switzerland has produced more than its share of distinctive national brands: Swiss cheese, the Swiss army knife, SwissAir and, of course, the Swiss numbered bank account. SwissAir is alas no more. Now, thanks to pressure from the European Union, another treasured national icon, the secret bank account, is under threat.

The EU is putting the squeeze on Switzerland to agree to divulge account details of EU citizens who have Swiss accounts and may be evading domestic tax. Throwing their weight around, EU foreign ministers this week threatened to suspend agreements liberalising trade and travel between Switzerland and the EU unless the Swiss quickly agree to a deal. Next week finance ministers are likely to ratchet up the pressure by threatening other sanctions, including possible restrictions on the movement of capital into Switzerland.

As the Swiss see it, they are the victims of internal EU politics. The origins of the fuss lie in an effort to crack down on tax evasion. Countries such as Germany and France worry that large numbers of their citizens are salting away money in secret accounts in Luxembourg—a member of the EU—to avoid paying tax on interest at home. The Channel Islands, which fall under British jurisdiction, are also a noted haven. Belgium and Austria, too, have traditions of banking secrecy.

To tackle this supposed problem, the EU considered a two-pronged approach: either all EU countries would impose a withholding tax (ie, a tax imposed at source on interest), or they would exchange information on account-holders. But the British fought tooth-and-nail against the withholding-tax idea, warning of grave damage to London's Eurobond market. They persuaded their European partners to go for “exchange of information” only. At this point, the secretive Luxembourgers objected, pointing out that if the average Belgian dentist were told that the details of his Luxembourg account were about to be wired to the tax authorities back home, he would simply transfer his money to nearby Switzerland. Get agreement from third countries to join in the great information swap, said Luxembourg, or we will veto the whole EU deal.

The European Commission in Brussels has accordingly been trying to hammer out a deal with the Swiss. The Swiss have not been completely obdurate. They have offered to impose their own withholding tax on EU citizens' funds, and to remit the proceeds back to the EU. Yet what the Swiss still refuse to do is to divulge details of which particular German or Dutch citizen has a numbered account in Zurich. The Swiss also complain that any deal will be pointless if the Union cannot reach agreement with other potential tax havens overseas, including the United States.

The EU is, in fact, trying to negotiate an exchange-of-information deal with the Americans, as well as with such European micro-states as Monaco and Andorra. The eurocrats had hoped that, in the new climate of the war on terrorism, the Americans would play ball. Instead Washington resents the idea, which may encourage the Swiss to hang tough. Meanwhile, the EU is having trouble showing a united front. The eurocrats reckon that Luxembourg is secretly egging on the Swiss, in the hope that the whole package will collapse. And Brussels is still furious with the British for blocking the withholding tax in the first place, forcing the EU into intractable negotiations with the Swiss.

Perhaps the whole idea will come to naught. The Swiss give little sign of being panicked by the threat of sanctions. Certainly, some of the ideas mooted—making it illegal for EU citizens to remit funds to Switzerland, or withdrawing the operating licences of Swiss banks within the EU—seem outlandish. The EU's fall-back position is to allow the Swiss to refuse an automatic exchange of information, if they will agree to provide information when there is a specific tax-evasion inquiry from an EU authority. The Swiss

are still not keen.

Certainly, a lot of money is at stake. Switzerland claims to have just under a third of the total global market for the management of the assets of rich people with overseas accounts. When the Italian government announced recently that it would offer an amnesty from prosecution for all Italians who returned money salted away in Switzerland, some *euro*50 billion ($49 billion) came back within months. And that was only a tenth of the Italian money held in their banks, the Swiss say.

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Economics focus

Roots of development

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From The Economist print edition

What matters most for development—geography, institutions or policy?

ECONOMIC growth in poor countries, it seems reasonable to suppose, depends on getting lots of different things right, and probably on a generous measure of good luck as well. Is it possible to say which factor or factors matter most?

For many years economists emphasised the importance of good economic policy (though often disagreeing about which policies were good and which not so good). Lately, it has become orthodox to stress the importance of long-lived "institutions" that are conducive to growth: political stability, property rights, legal systems, patterns of land tenure, and so on. Other economists instead put great weight on geography, especially climate (which affects the incidence of disease, the applicability of some technologies, agricultural opportunities, and more) and access to the sea (which affects the scope for international integration).

Such explanatory factors need not be mutually exclusive. Successful development could depend on all of the above. Rich economies usually combine competent policy (on the whole), sound and stable institutions and favourable geography. Many of the world's poorest countries score badly on all three counts. Still, it would be interesting to discover that policies, say, matter much more than geography—and it would be encouraging too, because policies are easier to change than whether a country is in the tropics or has access to the sea. A new paper* by William Easterly of the Centre for Global Development and Ross Levine of the University of Minnesota tests the importance of these three sets of factors, looking at a sample of 72 rich and poor countries.

The results are intriguing. Institutions turn out to matter most—but that is putting it mildly. Geography and policy, as influences in their own right, turn out to matter not merely less than institutions but, roughly speaking, not at all.

Take policy first. In this study the quality of policy is measured by inflation, openness to trade, exchange rates and so forth. The finding that policy in these areas does not drive development seems surprising, and at odds with a lot of other work, as the authors acknowledge.

One explanation may be that other studies relate good policies to growth rates, whereas Mr Easterly and Mr Levine relate it to the level of income. Why would that matter? Possibly, bad policies curb growth rates for a spell, but not enough to have a significant effect on incomes in the long term. Or the reason could be that some other studies fail to include institutions alongside policies as a possible explanation for development. If low-income countries with bad policies also have bad institutions, and institutions are not included in the analysis, then bad policies may act as a proxy for bad institutions, and appear to be the true underlying influence.

At any rate, the study finds that countries with good institutions tend to do all right with good or bad policies. In the same way, countries with bad institutions tend to do badly regardless.

Germ of an idea

Other studies say that geography matters a lot. In this case, Mr Easterly and Mr Levine agree, sort of, because they find that geography affects institutions. Favourable geography, they find, promotes good institutions; good institutions then promote development. When the study looks at the economic influence of geography in its own right—that is, does geography affect income independently of promoting good institutions?—they find no clear connection.

In itself, in other words, good geography does not seem to count. A country with bad geography and good institutions will do fine. A country with good geography and bad institutions will not. It is only in so far as good geography breeds good institutions that good geography promotes development.

But hang on. Why on earth should good geography favour good institutions? The authors explain that this odd-seeming finding is consistent with a plausible theory set out and defended empirically elsewhere**. The 72 countries in the sample are all former colonies. Europeans followed a variety of colonial strategies. In North America, Australia and New Zealand, Europeans settled in large numbers and created institutions to protect private property and curb the power of the state. In most of Africa and Latin America, Europeans never wished to settle and instead concentrated, to varying degrees, on extracting metals, cash crops and other resources: less democracy, less regard for property rights.

Why did Europeans settle in North America and not in Africa? Because of geography—that is, because of germs. Where settler mortality was low, because geography and climate were conducive to good health, Europeans moved in and planted good institutions. Where settler mortality was high, because of bad geography, they stayed away and planted bad institutions. These institutions, good and bad, put down roots—and the result, broadly speaking, is the pattern of income you see today around the world.

Institutions are more difficult to change than policies, of course. If that were not so, the European colonial legacy emphasised in this account of development would not have been so enduring. But institutions are presumably not as resistant to reform as geography. Spelling out more precisely—or with any precision at all—how to get from bad to good institutions is, on this view, the real challenge for development economics.

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* "Tropics, Germs and Crops: How Endowments Influence Economic Development". NBER Working Paper 9106.

** "The Colonial Origins of Comparative Development: An Empirical Investigation", by D. Acemoglu, S. Johnson and J. Robinson. American Economic Review 91, December 2001.

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About sponsorship

Light-emitting diodes

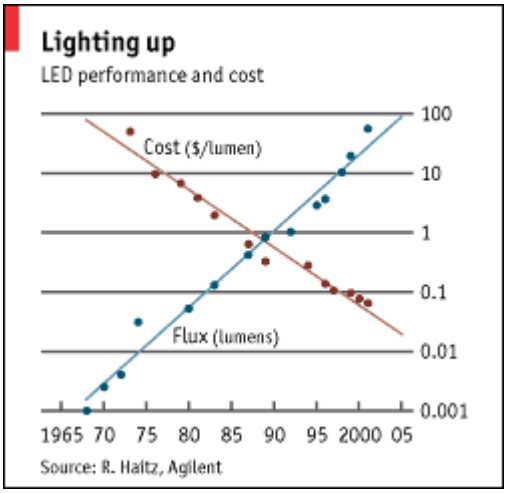
A solid future for lighting

Oct 3rd 2002
From The Economist print edition

Over the next decade, incandescent bulbs and fluorescent tubes are likely to give way to illumination based on solid-state semiconductors

IT SOUNDS like the start of a bad joke to ask how many companies it takes to change a light bulb. But the truth is that plenty are trying. The lighting industry thinks that the light bulb is dead and that the days of the fluorescent tube are numbered. It predicts that the future will be illuminated by light-emitting diodes (LEDs).

Although they are expensive to manufacture, LEDs are more efficient than bulbs at converting electricity into light. If existing trends continue they will soon be more efficient than tubes. And manufacturing costs are coming down at the same time as efficiency rises (see chart).



The diodes are better than existing lighting in other ways, too. They are durable, glowing brightly for tens of thousands of hours; and they are robust, resisting shock and not flickering. They have neither glass parts nor delicate filaments. Coloured ones are already used in traffic lights across America and, in a few years, white LEDs should be brightening homes and offices. They also offer novel possibilities. Coupled to fibre-optic cable, they could generate light centrally and route it through buildings. Lamps might work not with a dimmer switch, but with a rainbow dial that turned them from white to red, green, blue or any shade in between. Wallpaper that glows and twinkling table-tops also stray from the realm of the outlandish to become feasible notions.

An LED consists, in the simplest case, of two layers of semiconductor sandwiched together. One layer is “n-type”, meaning that it has an excess of negatively charged electrons. The other is “p-type” and is populated by “holes” left behind after electrons have been removed from the crystal structure. These holes have, in effect, a positive charge. When a current is applied across the sandwich, electrons and holes are pushed towards the junction between the n- and p-type materials. There, they meet and annihilate one another, releasing energy in the form of light. The colour of this light depends on the material that has been used to build the LED.

Although it has been known for decades that many semiconductors emit red or green light, it has proved hard to coax one into producing higher-energy blue light. Success came in 1995 when Shuji Nakamura, working for Nichia, a Japanese company, managed to build a blue LED from gallium nitride (work for which he recently won an innovation award from *The Economist*). This mattered because it takes all three primary colours to make white light—and if you want to replace bulbs and tubes, white is what you need.

In the end, it didn't quite happen that way. Attempts to build white-light emitters out of three coloured LEDs failed because the brightness of each component changed with temperature and age, so the colour of the composite light drifted off white. However, blue LEDs turned out to be the key to white light after all. The way to extract white light from a blue LED is to coat the top of the device with a layer of phosphor powder. The phosphor—a compound called yttrium-aluminium garnet—absorbs part of the blue light and is thereby "pumped" into an excited state. When it relaxes, the energy it has absorbed is re-emitted as yellow light. The combination of blue and yellow produces a rough approximation of white light.

Such quick and dirty white light is now available in the market. Lumileds, set up by Agilent Technologies and Philips Lighting, and based in San Jose, California, is one of the leading manufacturers of white LEDs. A 5W version (the most powerful so far) of the firm's Luxeon Star will be available this month. It produces the same amount of light as a 10W incandescent bulb. By putting these devices together in groups of 12, Lumileds has created a product that can stand in for a household bulb. Nichia, GELcore (a collaboration between General Electric and Emcore, a semiconductor company based in Somerset, New Jersey) and Osram also sell "white" LEDs that work this way.

Bright ideas

All of these companies are now busy working on the next generation of white-light emitters—ones whose output will be truly white. One way to achieve this is to employ an LED that emits ultraviolet light (UV, which is even more energetic than blue). The advantage of this approach is that many phosphors absorb UV efficiently. The recipes have been improved by years of development for fluorescent tubes, in which the UV is supplied by an excited gas rather than a semiconductor. By altering the balance of phosphors that emit at red, green and blue frequencies, the colour of the light can be controlled to account for vagaries of taste. People are, it seems, picky about the colour that they read by, preferring a red-tinted "warm" white to the blue-shifted "cool" spectrum of sunlight.

The best solution would be the one originally envisaged—to combine red, green and blue light generated directly by LEDs. That would waste less energy than "downgrading" UV into visible colours with phosphors. It would, however, mean building a feedback system that can cope with the irregularities of the LEDs in response to heat and age.

Color Kinetics, a Boston-based company, has used the multi-LED approach to build digitally controlled lamps that produce a light show with hundreds of colours. B/E Aerospace, a firm that designs interiors for airliners, plans to install such lamps in its products. According to Color Kinetics' website, the lamps will provide "a sunset ambience to encourage relaxation and sleep; a sunrise programme to awaken and re-energise passengers after an extended flight; and custom effects featuring an airline's signature colours to enhance its brand." You have been warned.

The really big money will come when LEDs can compete on price with everyday incandescent and fluorescent lighting. That is a market worth $12 billion around the world, according to Robert Steele, an analyst with Strategies Unlimited in Mountain View, California.

A light is judged by the number of lumens it throws (a lumen is a measure of brightness that accounts for the sensitivity of the human eye). The number of lumens per watt (lm/W) measures a light's efficiency, while the number of dollars per lumen measures its cost. On both counts, solid-state lighting has some way to go.

The best white LEDs on the market emit 25 lm/W, which is almost twice as efficient as an equivalent tungsten-filament light bulb, but barely a third as good as a fluorescent tube. To become competitive, the devices need to reach 80 lm/W. To rule the world, 150 lm/W is probably required. If progress continues at the rate of the past 30 years, this will be reached by 2010. That is a big if, but the efficiency of blue and UVLEDs should improve dramatically as better ways are found to build them.

Just in case progress should be slower, governments are sticking their noses in. Japan has created a "Light for the 21st Century" project that will run until 2004. America is also considering applying a little industrial policy: $480m will be made available over the coming decade if the "next generation lighting initiative" survives in the energy bill now being debated in Congress. With luck, though, the technology will rise above such interference. Light bulbs could then be consigned to the dustbin for ever.

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The genomics of malaria

Two's company

Oct 3rd 2002
From The Economist print edition

The complete genomes of both the parasite that causes malaria and the mosquito that carries it have now been unravelled

Get article background

ANOTHER day, another genome. What was once a matter of intense scientific interest—mapping the entire genetic material of a species—has become routine. But not all genomes are equal in the sight of humanity. Details of two that are of more interest than most have just been released.

Malaria has probably been the most lethal infection in history. At the moment, it is thought to kill around 2.7m people a year, 1m of them children. In addition to the suffering caused, that has huge economic consequences. Over the past 25 years, according to Jeffrey Sachs, an economist at Columbia University, the annual growth rates of countries with endemic malaria have been 1.5 percentage points lower than those in comparable non-malarial countries. Understanding the genetics of *Plasmodium falciparum*, the parasite that causes the disease, and of *Anopheles gambiae*, the mosquito that carries it, should be a big step towards correcting those numbers.

Two parallel projects designed to map these genomes have been running for the past few years. Although these projects have, like all public genome-projects, been reporting results as they go along, the organisers of both have co-ordinated the formal publication that marks the point where the work is officially declared to be “done”, even if the odd gap remains here and there.

The results have been carved up between *Science* and *Nature*, two leading scientific journals. *Science* got the mosquito and *Nature* the parasite. Between them, this week's issues of the two magazines have about 30 papers describing and commenting on the work, which has involved some famous institutions that have not always seen eye to eye in the past. For instance, Celera Genomics, an American biotechnology company, and the Sanger Centre, a charity-financed British laboratory, were on opposite sides in the race to sequence the human genome. Malaria has them batting on the same team.

Blood brothers

Biologically, the more interesting of the two creatures is *Plasmodium*. Mosquitoes are flies, and flies, in the shape of the geneticists' favourite fruit fly, *Drosophila*, have been genomically anatomised already. *Plasmodium*, on the other hand, is virgin territory. Although, like mosquitoes, it belongs to the eukaryotes (the group of living organisms that includes animals, plants and fungi, as well as many single-celled species), it is a peculiar example of that group. That was known before the project was started, but sequencing has confirmed *Plasmodium*'s oddity.

Since all living things are related, and lots of their biochemical processes are shared, genes are also shared—or are, at least, recognisably similar—in many species. That, however, is less true of *Plasmodium* than of most organisms looked at so far. About 60% of the 5,268 genes which the researchers think they have identified in this bug are new to science. On top of that, *Plasmodium* turns out to be closer genetically to plants than to animals.

This may have something to do with its unusual evolutionary history. All eukaryotes are “compound” organisms. They contain structures called mitochondria, distant descendants of bacteria that became symbiotic with the first eukaryotic cells. In addition to their mitochondria, plants have a second relic symbiont, the chloroplast. But *Plasmodium*, though it lacks chloroplasts, has a relic symbiont known as an apicoplast that is not found in other eukaryotes. This is believed to be the remains of an alga and, like

a mitochondrion or a chloroplast, it has a small genome of its own. It has also passed genes to *Plasmodium*'s nucleus. Algae are plants (or at least the ancestors of plants—it depends which botanist is doing the classifying). The apicoplast seems to have given *Plasmodium* a lot of plant genes, too.

More practically, the researchers have identified 208 genes (4% of the total) that seem to be involved in evading the immune systems of the parasite's two hosts, man and mosquito. That should help those designing vaccines against it. And, unlike other genome projects, the *Plasmodium* work has been going on in parallel with a proteome project, intended to identify the actual proteins for which the genes are merely the encoded instructions.

This side of the research has identified 1,289 proteins. More significantly, it has shown which are produced during what stages of *Plasmodium*'s fiendishly complicated life-cycle. That is helping to pinpoint proteins that might be suitable targets for drugs. Several of *Plasmodium*'s digestive enzymes look promising.

The DNAof *Anopheles*, not surprisingly for a creature that is so much bigger, turns out to have almost three times as many genes in it as does *Plasmodium*'s. Despite the 250m years that separate it from its last common ancestor with *Drosophila*, its genes are reminiscent of those of its fruit-fly relative. There are differences, of course—notably in families of genes connected with immunity to infection. But there are few surprises. The hope, nevertheless, is that analysing both genomes in parallel (and also alongside that of humanity) will yield insights that would not otherwise be gleaned. And if that hope is realised it might, at last, be possible to defeat malaria.

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Internet topology

What does the Internet look like?

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It is less random than people thought

FEW questions are simultaneously so baffling and so significant as: “what is the structure of the Internet?” Baffling, because the thing has grown without any planning or central organisation. Significant, because knowing how the routing computers that are the net's physical embodiment are interconnected is vital if it is to be used properly. At the latest count, there were 228,265 of these routers around the world. They direct the packets of data that make up Internet traffic.

Any effort to map the Internet is necessarily incomplete and out of date the moment it appears. Instead, Albert-Laslo Barabasi and his colleagues at the University of Notre Dame, in Indiana, treat the net as though it were a natural phenomenon. What scientists generally do with a natural phenomenon that they do not understand is to build a model of it. Dr Barabasi's latest paper on the matter, just published in the *Proceedings of the National Academy of Sciences*, presents a general framework for improving the accuracy of Internet models.

Until 1999, the standard way of modelling the Internet was to use randomly generated graphs, in which routers were represented by points and the links between them by lines. But it turns out that such random graphs are a poor approximation because they miss two important features. The first is that links in the net are “preferentially attached”: a router that has many links to it is likely to attract still more links; one that does not, will not. The second is that the Internet has more clusters of connected points than random graphs do. These two properties give the Internet a topology that is scale-free—in other words, small bits of it, when suitably magnified, resemble the whole.

Dr Barabasi noticed that the World Wide Web (the most visible bit of the Internet) was scale-free in 1999. His observation touched off a flurry of research, and others pointed out that the Internet as a whole was scale-free, too. This has several implications. On the one hand, scale-free topology is resistant to random failures—one reason the Internet, despite the lack of artifice in its design, has proved so reliable. On the other hand, because there are disproportionately many hubs (as well-connected routers are known), the net is particularly susceptible to deliberate attacks on those hubs, the sort of thing that cyberterrorists might attempt.

The goal, Dr Barabasi says, is to create models that are statistically indistinguishable from the real Internet. When and if that is achieved, the models should have predictive, as well as descriptive, power.

Already, understanding the net's scale-free structure has led to new results. For example, it had long been thought that the best way to curb the spread of a computer virus was to change the software of machines on the net so that they were less easily “infected”. Studies using random graphs had shown that changing the software on more and more machines had a cumulative effect. That is not true in a scale-free setting. There, most software changes make no difference to the rate at which a virus spreads (although they obviously protect the machines in question). However, treating a relatively small number of hubs in a scale-free system can stamp viruses out completely.

That observation may have implications beyond the virtual world. Research has shown that the network of human sexual partners seems to be scale-free, too. In other words, some people have all the luck, while others have none. So stopping the spread of a disease such as AIDS may be a comparatively simple matter of getting treatment to the right people—a strange but real corollary to a piece of research on cyberspace.

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About sponsorship

Daniel Ellsberg

The value of dissent

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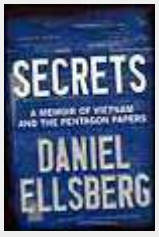
Corbis

Daniel Ellsberg was the ultimate government insider until he discovered that leaking information could be a patriotic act

A DIFFERENT war, a different time. But for those who still anguish over America's part in the Vietnamese conflict—and there are many—Daniel Ellsberg holds a position of some significance. His name may not ring an immediate bell for today's university students or political activists; but it was Mr Ellsberg, the ultimate defence intellectual and government consultant, who moved from helping plan and calibrate the war effort to revealing internal documents that laid bare the steady disappointments and deceptions of America's policy in South-East Asia.

The act that made him famous was his leak of a long Defence Department study scrutinising the war up to the late 1960s, soon known as the Pentagon Papers. In June 1971, the *New York Times* published the first instalments of what was to be a series based on this study, which he himself had helped write. The Nixon administration intervened to block further publication. But later that month, after an epic legal battle, the Supreme Court ruled that the *New York Times* was free to proceed. Mr Ellsberg was charged with spying and theft of government property, but the case against him fell apart in 1973 amid bizarre revelations of administration misconduct.

Secrets: A Memoir of Vietnam and the Pentagon Papers
By Daniel Ellsberg



Viking; 498 pages; $29.95

Buy it at
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Amazon.co.uk

It has taken more than a quarter of a century for Mr Ellsberg, now a senior citizen of American protest, to deliver himself of his own story, and, somewhat surprisingly for a figure who is so self-obsessed, he has written a book worth the wait. It is good to hear directly from him about his transformation, and his account is calm and convincing.

The most compelling sections of this memoir are not about the Pentagon Papers affair itself, but about Mr Ellsberg's years as part of the problem he ultimately set out to correct. It is chilling to read his description of the refusal of seemingly brilliant and otherwise admirable officials in the Johnson administration, of whom he was one, to express their dissenting views about Vietnam policy in writing or in meetings. Instead, they got along by going along and measured their success in terms of loyalty, not honesty.

Mr Ellsberg was especially good at this. Although he says he already had profound doubts about the war, he describes the exhilaration of working through an entire February night in 1965 compiling an inventory of alleged atrocities by Vietnamese communists that could be used to justify massive bombing missions in both the north and the south of the country. “That night's work was the worst thing I've ever done,” he now believes.

But what was he to do? The tone was set by Robert McNamara, then the secretary of defence, who is shown here in one chapter on a flight back from Saigon to Washington in October 1966 acknowledging to colleagues that in Vietnam “the underlying situation is really worse”, only to claim on the tarmac at Andrews Air Force Base on arrival that “we're showing great progress in every dimension of our effort.”

Ultimately, Mr Ellsberg concludes, President Johnson's “ability to escalate depended on secrecy and lying.” And, despite all the claims to the contrary, he concludes, journalists were no match for the master politician and his lieges. “It became clear to me,” Mr Ellsberg says, that they “had no idea, no clue, even the best of them, just how often and how egregiously they were lied to.” Members of Congress, in his view, were equally helpless and hopeless, and could not be counted upon to ferret out the truth.

The courage of troublemakers

Thus it was that he came to believe that leaking could be a patriotic act, as he puts it, even at the risk of a long prison sentence. Mr Ellsberg describes first handing over secret memos to Neil Sheehan of the *New York Times*, to whom he later gave most of the Pentagon Papers. As if to test the system again, Mr Ellsberg discusses in this book a little-known Canadian intervention during the long Vietnam peace negotiations, details of which he assures us are still classified to this day.

“Secrets” will be of value to readers interested in recent history for the light it sheds on America's engagement in Vietnam. But it bears also on the present. It reminds us of the importance of dissent within democracies in time of war—a test that, with regard to Vietnam at least, America can claim to have passed, thanks in the end to its press, its courts and the courage of troublemakers like Mr Ellsberg.

Secrets: A Memoir of Vietnam and the Pentagon Papers.
By Daniel Ellsberg.
Viking; 498 pages; $29.95

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Historical biography

Lloyd George knew my father

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IT WOULD be hard to imagine a modern prime minister seeing three sons off to war while in office, but H.H. Asquith, Britain's Liberal prime minister between 1908 and 1916 did just that. His three elder sons fought on the western front, one having also served at Gallipoli. The youngest, an outstanding soldier, much decorated, lost a leg. The second suffered shellshock, then unrecognised as such, before returning to fight at Passchendaele. The oldest, Raymond, was killed in 1916.

Asquith, it appears, did not write to his boys in the trenches, though it is said that he never recovered from Raymond's death. This omission is one of the few black marks against him in Colin Clifford's book. Falling somewhere between history and family biography, it draws heavily on family papers, many of which have already been published. For new material he has mined the voluminous and spirited journals of Asquith's second wife, Margot.

The Asquiths
By Colin Clifford

John Murray; 528 pages; £25

Buy it at
Amazon.co.uk

Helen, Asquith's first wife, died in 1891, leaving him with five young children, the three soldiers as well as Violet (later Bonham Carter) and Cyril. He remained a lone parent for several years until his marriage to Margot Tennant, a member of a rich and well-connected Scottish family. Lively and witty—also a keen woman to hounds and a notch or two above him socially—she was entirely unsuited to being a stepmother. With Violet, in particular, an intelligent, articulate child, devoted to her father, she had an impossible relationship. Both were passionate about politics and both vied for Asquith's attention. They did try, largely without success, to understand and accommodate each other. Of Margot's five children, only two survived infancy. Their deaths contributed to her nervy unhappiness in later life, when her straight talking, so refreshing when young, became tactless and overbearing.

The boys were clever, Raymond exceptionally so. “The whole Asquith family overvalue brains,” wrote Margot. “I'm a little tired of brains: they are apt to go to the head.” Friends and colleagues included Churchill, Grey, Kitchener, Rupert Brooke and D.H. Lawrence, who are vividly there in the Asquiths' letters. Margot's are full of pith and comment, Violet's shrewd and descriptive, Asquith's wise, and to a favoured inamorata, Venetia Stanley, affectionate.

This is an engrossing book showing a gilded family so instrumental in the prosecution of the war and so affected by it in their daily lives, from the nursery to the drawing-rooms of London, the trenches and the House of Commons. Mr Clifford greatly admires Asquith, rating him a wise and unostentatious statesman of genuine integrity. Three months after Raymond's death, Asquith was outmanoeuvred in cabinet, forced to resign and succeeded as prime minister by Lloyd George, for whom Mr Clifford has little time, regarding him as the progenitor of spin. Violet's opinion was even less favourable. She defended her father's reputation with passion till the day she died.

The Asquiths.
By Colin Clifford.
John Murray; 528 pages; £25

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Against Napoleon in Spain

Spanish lessons

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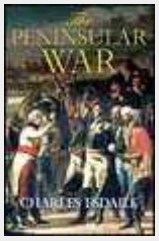
From The Economist print edition

CHARLES ESDAILE sets out to explode two myths of the Peninsular war against Napoleon—the guerrillero version, which romanticises the squalor and depravity of the partisans; and an anglocentric narrative which writes the home armies out of British victories. The Spanish regulars ought in theory to benefit from this approach, but a whiff of the anti-hispanic Black Legend still hangs over Mr Esdaile's account, which all too often stresses the inefficiency and factionalism of local forces.

He has done impressive work in the libraries and makes a valiant effort to describe the culture and politics of the war, but he relies overly on British memoirs and despatches, which inveighed against Spaniards' cussedness and chaos. Rather than won by the allies, the war emerges as lost by the French: Napoleon's grand strategy put prestige above practicalities; his marshals behaved like satraps and wasted effort on manoeuvres among themselves.

The Peninsular War: A New History
By Charles Esdaile



Allen Lane, The Penguin Press; 587 pages; £25

Buy it at
Amazon.co.uk

So far, so good. But there is scope for more radical revisionism. Mr Esdaile attributes Spanish victories to forces luckier than they deserved; he is nearer the truth when he admits they had an “unlucky but persevering national army”. No other state in Europe resisted French invasion so consistently, for so long. The Spaniards would never admit they were beaten; Napoleon judged their resistance to be his empire's undoing.

The British launched annual invasions from 1808 until 1812, all of which failed. The breakthrough of 1813 happened not because of Wellington's genius but because allied reorganisation brought, for the first time, a unified command, and because disaster elsewhere had sapped French strength. The Peninsular campaign was to the Napoleonic wars what north Africa was to the second world war—an arena of British failure, redeemed by victory only when the enemy broke one of the great laws of war: never invade Russia.

The Peninsular War: A New History.
By Charles Esdaile.
Allen Lane, The Penguin Press; 587 pages; £25

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About sponsorship

American legends

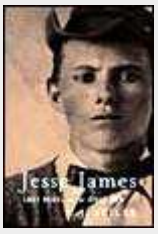
A Confederate robber

Oct 3rd 2002
From The Economist print edition

JESSE JAMES rode the finest bay horses in Missouri. When one collapsed he stole another and rode on. He robbed trains and banks with a winning smile. In this excellent account, T.J. Stiles shows James to be a southerner, not a westerner; a Confederate, not a cowboy. He was a product of the civil war and its aftermath.

His motivation, at least to begin with, was political. Missouri experienced a literal civil war, in which neighbours slaughtered each other in their own homes. At 14, James blew the tip off a finger loading revolvers for the local Confederate guerrillas, the bushwhackers. At 15, he joined them, riding with the psychotic Bill Anderson, who urged his men to scalp and mutilate the Union men they slew.

Jesse James: Last Rebel of the Civil War
By T.J. Stiles



Knopf; 510 pages; $27.50.

Buy it at
Amazon.com
Amazon.co.uk

Mr Stiles masterfully strips James bare. He is less interested in his legend than his times. The fragile Reconstruction economy was dependent on the movement of cash money by train, providing James with easy targets, which he chose to see as political. “Just give us the government money,” he would instruct those he held up. It was a form of terrorism: by discouraging settlement of Missouri, he thought to preserve its southern character. The Ku Klux Klan was founded in 1866 in response to blacks winning elected office; James and the bushwhackers who saddled up with him were another reaction. Confederates banned from political office used him.

John Edwards, a Confederate newspaperman, became his official interpreter. He printed letters James wrote, railing against Reconstruction. Here was a southerner willing to appeal once more to the sword, Edwards roared. Many readers agreed. His mother, Zerelda, never accepted her boys were criminals. Jesse, she said, was going to the cooler, the Reconstructionists to hell. But her son rode through a hell of his own making. He and his brother eluded capture after a failed Minnesota robbery by riding for days with gunshot wounds. He knew he was bad; in 1869 he had himself struck off the Baptist roll. He had a presence. Witnesses spoke of his piercing blue eyes, smart clothes, easy charm and swagger.

His downfall came with the demise of Reconstruction in 1877. In some ways, the civil war had been refought and the Confederates had won. His sympathisers, now returned to office, no longer saw his political point. In 1882, he was shot in the back of the head by one of his own gang for reward money. His brother surrendered directly to the governor of Missouri soon after and was acquitted.

“The James territory”, a contemporary wrote in *The Nation*, “seems to closely resemble, in its religious and moral condition, a Frankish kingdom in Gaul in the sixth century.” With James in a coffin—his hair and beard dyed black in disguise, his body pitted and white with old bullet holes—it grew safer but less interesting.

Jesse James: Last Rebel of the Civil War.
By T.J. Stiles.
Knopf; 510 pages; $27.50.
To be published in Britain by Jonathan Cape in January 2003

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About sponsorship

New American fiction

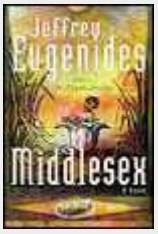
Bits and pieces

Oct 3rd 2002
From The Economist print edition

THE success of Jeffrey Eugenides's first novel, “The Virgin Suicides”, must have pressured him to prove that his haunting debut was not a fluke. Perhaps that helps to explain why “Middlesex” was nine years in coming. But in the event, high expectations have backfired. Like a boy trying on his father's suit, “Middlesex” is a small-fry in a big jacket.

Raised as a girl, the protagonist Calliope Stephanides is discovered at 14 to have a shy but increasingly insistent penis. Had Mr Eugenides constrained himself to the tale of a pseudohermaphrodite (genetically of one sex but with ambiguously developed genitals), his novel might at least have shed some light on the psychology of gender. Yet Callie's story doesn't get off the ground until halfway through this ponderous book. Meanwhile we are treated to yet another intergenerational saga about the immigrant experience in America.

Middlesex
By Jeffrey Eugenides



Farrar, Straus & Giroux; 529 pages; $27.
Bloomsbury; £16.99

Buy it at
Amazon.com
Amazon.co.uk

Facilitating the emergence of Callie's rare hermaphroditic gene, her Greek, Turkish-born grandparents are brother and sister. The incest seems not dark but quaint. Indeed, the prose in “Middlesex” is oppressively perky, with a plague of exclamation marks. Illustrative of the novel's chirpy texture is the decision to name Callie's brother “Chapter Eleven”. Such a christening by traditionalist second-generation Greeks is far-fetched, but the author clearly couldn't resist. Similarly, Callie's deformity and resultant sexual confusion are related with bouncing folksiness, begetting agony-lite.

Heavy-handedly inscribed into the three generations of Callie's family is, of course, the whole arc of the 20th century—the Depression, war, the 1960s, and Watergate. Though Detroit is a distinctive choice of setting, the historical material feels stale and second-hand. Mr Eugenides seems to be trying to compete with other writers who have problematic pretensions of their own—David Foster Wallace, Jonathan Franzen—and has weighed in with a doorstop. A shorter, more focused treatment of sexual ambivalence made flesh wouldn't have kept the kitchen door ajar, but it might at least have been fun to read.

Middlesex.
By Jeffrey Eugenides.
Farrar, Straus & Giroux; 529 pages; $27.
Bloomsbury; £16.99

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Russian composers

Modesty and melancholy

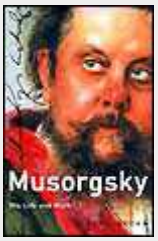
Oct 3rd 2002
From The Economist print edition

IT IS perhaps only fitting that Modest Musorgsky's last public appearance, before he died in 1881 at the age of 42, should have been to play at a memorial service for the novelist, Fyodor Dostoevsky.

The composer's life epitomised one of those depressed and fatalistic characters that so abound in Russian fiction and drama. An alcoholic from his teens, Musorgsky achieved little success in the concert hall. His only well-known piece of orchestral music is “St John's Night on the Bare Mountain”, while his most famous piano sequence, “Pictures at an Exhibition”, as well as his best-known operas have all been rearranged by other people.

The stark and chilling sounds that Musorgsky created to depict the angst-ridden life of the tsar in “Boris Godunov” make this one of the most powerful and influential stage works of its time. Yet the best known arrangement of the opera was made after the composer's death by a colleague, Nikolay Rimsky-Korsakov. This version, exciting though it is, gives little idea of the originality of Musorgsky's own orchestration. Similarly, “Khovanshchina” and “Sorochintsy Fair” were both left unfinished at his death, and exist only in versions completed by others.

Musorgsky: His Life and Work
By David Brown



Oxford University Press; 336 pages; $35 and £25

Buy it at
Amazon.com
Amazon.co.uk

David Brown has avoided speculating about Musorgsky's private life, details of which remain sparse. Instead, he has chosen, in this fine overview of Musorgsky's career, to emphasise his relationships with the other composers of the emerging Russian school—Cui, Borodin and Tchaikovsky among them—and his mentor and colleague Mily Balakirev. Although he had no academic musical training, Balakirev had a genius for encouraging others and immediately understanding their work. He was closely involved in helping Musorgsky to finish “St John's Night on the Bare Mountain” as well as some of the operas.

Of Musorgsky's songs, which are also too little known, Mr Brown rightly says, “song composition is the one thread that runs through Musorgsky's entire creative life”. Filled with relentless pessimism, the song cycles such as “Sunless” and “Songs and Dances of Death” may never achieve great popularity. Yet among Musorgsky's large portfolio of songs there is charm and humour—and always that yearning for the romance of the countryside, which, with all its “layers of pain and turmoil”, Mr Brown shows, is all so Russian.

Musorgsky: His Life and Work.
By David Brown.
Oxford University Press; 336 pages; $35 and £25

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About sponsorship

Proust in translation

Love by osmosis

Oct 3rd 2002
From The Economist print edition

Why to welcome 3,000 new pages of the masterpiece by Marcel Proust (1871-1922)

THE Proust *nouveau est arrivé*. The product of seven translators working under the editorship of Christopher Prendergast, a French scholar at Cambridge, this claims to be the first completely new translation of “A la recherche du temps perdu” since the famous version by C.K. Scott Moncrieff, who discovered his vocation during Proust's lifetime, but who died in 1930 still working on the last volume.

In Search of Lost Time
By Marcel Proust
Edited by Christopher Prendergast, Lydia Davis, James Grieve, Mark Treharne, John Sturrock, Carol Clark, Peter Collier and Ian Patterson

Penguin, Allen Lane; 3155 pages; £75. To be published in America by Penguin Putnam in late 2003

Buy it at Amazon.co.uk

Penguin's claim of newness is defendable but needs some explaining. The first scholarly French edition came out only in 1954, and it was on this that the late Terence Kilmartin, then literary editor of the *Observer*, based his comprehensive 1981 “reworking” of Scott Moncrieff's translation. The French text, however, did not stand still. In 1987-89, a new Pléiade edition supervised by Jean-Yves Tadié, Proust's biographer, appeared in France, complete with detailed notes and alternative drafts, which almost doubled the length. Kilmartin duly began a revision of his revision, based on the new French text, minus the scholarly apparatus. This translation was completed on his death by D.J. Enright, an English poet and novelist, and published in 1992 as a “definitive version”.

Although it pays tribute to its two recent English predecessors, the Penguin version is an entirely new translation, and the question has to be asked, why a third? The straightforward answer is that Penguin commissioned it, with an eye to a general readership in the hope of making Proust more accessible.

A different sort of answer is that the question itself is useless. For his admirers there cannot be too many Prousts available in English or French: it is always necessary to read and reread. In this way we experience, in our turn, the assertion of memory. Rediscovering the servant Françoise, when, carrying her lamp, she enters the room after Marcel has persuaded Albertine to go to bed with him; being reminded of the revelations of the Vinteuil sonata; rereading the description of the church spires of Martinville: all this is essential. And for those who have not begun, here is the opportunity to take this clear and carefully presented translation and to begin on the affair of a lifetime.

At more than 3,000 pages, the text was evidently too much for one scholar to complete in reasonable time, and an entire team was summoned. While clearly a solution to one difficulty, Mr Prendergast says little about the problems it may have caused in turn, and he skirts the issue of how far he unified the translations, except in practical matters such as personal titles, quotations and punctuation.

Instead, each translator writes an introduction to the relevant volume, usually explaining their attitude to translation and providing short synopses and notes. Ian Patterson, for example, who worked on the sixth and last volume, “Finding Time Again” (Le temps retrouvé) raises the question of textual accuracy, which has always been difficult because of Proust's constant revisions and because so much of the work was published only after he died.

It is in the titles of the different volumes that one immediately notices the changes. Scott Moncrieff's memorable Shakespearian “Remembrance of Things Past” is gone. Proust himself disliked it and everyone appears to agree that “A la recherche du temps perdu” implies not only time “lost” but also time “wasted”, while *à la recherche* signifies something that is quasi-scientific and experimental, distant from the comfortable English “remembering”. So, if one concentrates on the full implications of the words (and with Proust concentration is essential), “In Search of Lost Time” becomes quite acceptable.

General success

Leaving the titles—although “Finding Time Again” for the magnificent final volume is surely a let-down—you are struck, when turning to the text, by the general success of these translations. James Grieve, who did volume two, “In the Shadow of Young Girls in Flower”, reminds us that Proust's writing can be so slipshod that editing it becomes unavoidable. Yet in seeking to produce something equivalent to the French rather than a version that has been manipulated to make it more comprehensible, the translators have produced something very readable.

Oddly, it is not the long sentences that appear awkward—although, in reading about the theatre party with the Duchesse de Guermantes, we are told, “The Princess, with a movement that generated an exquisite contour which my mind pursued into the void, had just turned her head towards the back of the box”, which requires some working out. Rather, it is the short sentences that can be clumsy. Thus, of the fire in Saint-Loup's room in Doncières, “It could not keep quiet; it was shifting the log about and very clumsily. I went in. It sent one log rolling and sent another smoking. And even when it was still, as common people do, it made constant noises.”

Sometimes the English seems inadequate to the emotional scene it describes. Thus when the narrator hears his mother coming to give him his goodnight kiss, “It announced the moment that would follow it, in which she had left me, in which she had gone back down.” And in the dramatic final sentence of the first volume, “et les maisons, les routes, les avenues, sont fugitives, hélas! Comme les années”, the word “fugitives” is translated by the commonplace “fleeting”.

John Sturrock, in his introduction to “Sodom and Gomorrah”, writes of Proust's preoccupation with the time delays in our emotional lives. Thus the narrator only suffers the full effects of his beloved grandmother's death when he later stays at the same hotel at Balbec, where they had once stayed together. This is one of the memories around which the whole work is constructed. And one can add that, when we read the pages where he waits in the Duchesse de Guermantes's library and reflects on the resurrections of memory that he has experienced, then we welcome this Penguin edition that will enable others to read, reread and grow to love such passages in the same way.

In Search of Lost Time.
By Marcel Proust
Penguin, Allen Lane; 3,155 pages in six volumes; £75. To be published in America by Penguin Putnam in late 2003

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About sponsorship

Kathleen McGrath

Oct 3rd 2002
From The Economist print edition

Kathleen McGrath, warship captain, died on September 26th, aged 50

California State University

TWELVE women have risen through the “brass ceiling” of the United States navy to become admirals. But most of them earned their flag for qualities only indirectly connected with combat. Grace Hopper, “Amazing Grace”, was made an admiral in 1983 chiefly for her work on naval computers. Others have done well in the navy in recruiting work and medicine. Those who made it to sea have commanded nothing more lethal than supply ships. So there was great interest in 2000 when Kathleen McGrath became the first woman to command an American warship, USS *Jarrett*.

Everyone likes a pioneer, and American women especially could feel for Captain McGrath, away from her husband and their two small adopted children. Nor was her task without danger. For several months the *Jarrett* patrolled the Gulf off Iraq, her crew of 262 searching ships suspected of breaking United Nations' oil sanctions. The *Jarrett* is one of the smallest ships in the navy, but with fire-power greater than that of a battleship of the second world war. That fact raised a matter rather deeper than the more prosaic one of a wife's temporary separation from her family. How did Captain McGrath feel about having the means at her disposal to kill and destroy? She said she did not try to “emulate a man”. She had to be herself.

It was an enigmatic response that has done nothing to settle the argument of whether women are fitted for the sharp end of war. Formally, the armed forces of the United States and most countries of Europe allow women to be trained for combat, although in practice few get to fire a gun in anger. Mostly they serve in vast military bureaucracies, freeing men for more aggressive duties. But, like Captain McGrath, not all women drawn to military work are content to be non-combatants.

Into uniform

Kathleen McGrath spent much of her childhood on the Pacific island of Guam, the site of an American military base. Her father was stationed there as a bomber pilot during the Vietnam war. After graduating she worked on forestry conservation, but after six years felt there must be more to life than looking after trees. She followed her father's advice to try flying, but the air force recruiting office near her home was closed for lunch. The navy office nearby was open, so, as she put it, she became a sailor by accident.

If Miss McGrath's early years suggest drift, putting on a uniform seemed to transform her. The recruiting officer had promised her adventure, and she was determined that the navy should keep to its promise, not diverting her into an office job. She recalled the words of one of her American heroines, Elizabeth Hoisington, “If I had learned to type, I never would have made brigadier-general.” In the 1980s and 1990s, the navy gradually put aside its reluctance to promote women to senior posts, while reassuring men that they were not being sidelined: the navy has more than 200 male admirals. Frank Kelso, an admiral of traditional ways, said in 1991 that he did not want women in warships at all, even as nurses, although they had served in the American navy since 1812. Women affected “combat effectiveness”, he said. But the times were against him: the navy could not recruit enough men to crew its 300 or so ships alone; and, politically, the demand for equal opportunity had spread from the civilian world to the armed forces. In the 1990s even “Star Trek”, a space soap, introduced a fearless female commander, Captain Janeway.

The navy recognised that in Kathleen McGrath it had a natural sailor, and a possible star. She was given

experience in a variety of ships in a variety of seas and conditions from the Pacific to the Mediterranean. Her first command was of a salvage ship, *Recovery*, but her eyes were on warships. Sailing on one, she said, was like driving a sports car. It was “sexy and glamorous”. The phrase appealed to the navy's publicists. Pictures of pretty women engaged in what is usually regarded as man's work are a boost to recruiting. Pictures of Kendra Williams piloting a plane from an American carrier to drop bombs on Iraq in 1998 were used in newspapers throughout the world.

They also raised the non-glamorous side of war. However euphemistically combat is termed, it involves killing people and the risk of being killed yourself. Most women may not be as combat-ready as Miss Williams and Miss McGrath. Much has been written on this subject about the stoic Russian women pilots, tank-drivers and snipers of the second world war. But they were relatively few. Women were more valued as mothers to replace the millions of Russians being killed in the war.

Stephanie Gutmann, author of “A Kinder, Gentler Military”, raises the question of whether “feminisation” will weaken America's armed forces. Only a full-scale war, she says, will test whether young men and women can work together intimately in conditions of high stress. In her last days in the navy Kathleen McGrath was studying “advanced war-fighting”. Had she, as was expected, risen ever higher in the navy, perhaps to become a member of America's joint chiefs of staff, no doubt she would have continued to pursue the problems of women in combat. Alas, cancer cut her down.

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Overview

Oct 3rd 2002
From The Economist print edition

Most **stockmarkets** hit new five- or six-year lows before bouncing back briefly. At its low point, Germany's Xetra DAX index showed a loss of 66% from its peak in 2000.

America's ISM survey of purchasing managers fell to 49.5 in September, from 50.5 in August. This is the first time since January that the index has dipped below 50, and it suggests that factory output is contracting again. Motor vehicle sales, previously boosted by zero interest-rate loans, slumped by 13% in September.

Euro-area manufacturing may be sliding back into recession. The Reuters/NTC purchasing managers' index fell from 50.8 to 48.9 in September. The European Commission's composite index of business and consumer sentiment in the euro area recovered slightly in September, but by less than expected. Businessmen remained particularly gloomy. The euro area's jobless rate remained at 8.3% in August, but recent lay-offs suggest that it may soon rise. Despite sluggish demand, the European Central Bank will be in no hurry to cut interest rates: inflation rose to 2.2% in September—above the ECB target.

Industrial production rose by 1.9% in **Japan** in the year to August. But the Bank of Japan's September *Tankan* survey of companies suggested that Japan's recovery may be faltering. Among businessmen, pessimists still outnumber optimists by a wide margin.

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Output, demand and jobs

Oct 3rd 2002
From The Economist print edition

% change on year ago

	GDP		The Economist poll GDP forecasts		Industrial production	Retail sales (volume)	Unemployment % rate	
	1 qtr*	1 year	2002	2003	latest	latest	latest	year ago
Australia	+ 2.4	+ 3.8 Q2	+ 3.8	+ 3.5	+ 4.3 Q1	+ 6.3 Q2	6.2 Aug	6.8
Austria	na	+ 0.4 Q2	+ 0.7	+ 1.9	+ 2.2 Jul	– 0.2 Jun	4.2 Aug	3.6
Belgium	+ 0.8	+ 0.3 Q2	+ 0.6	+ 2.0	+ 3.8 Jul	– 4.2 Jun	12.0 Sep†	11.7
Britain	+ 2.4	+ 1.3 Q2	+ 1.6	+ 2.7	– 2.5 Jul	+ 5.0 Aug	5.2 Jul‡	5.1
Canada	+ 4.3	+ 3.2 Q2	+ 3.3	+ 3.3	+ 1.3 Jun	+ 6.3 Jun	7.5 Aug	7.3
Denmark	+ 4.4	+ 2.2 Q2	+ 1.7	+ 2.1	– 1.6 Jul	+ 4.1 Jun	5.1 Aug	5.1
France	+ 2.0	+ 1.0 Q2	+ 1.1	+ 2.2	– 1.7 Jul	+ 3.5 Aug	9.0 Aug††	8.7
Germany	+ 1.1	+ 0.1 Q2	+ 0.4	+ 1.6	– 1.9 Jul	– 2.2 Aug	9.9 Aug§	9.3
Italy	+ 0.9	+ 0.2 Q2	+ 0.5	+ 1.9	+ 0.9 Jul	nil Jul	9.0 Jul	9.5
Japan	+ 2.6	– 0.7 Q2	– 0.7	+ 1.0	+ 1.9 Aug	– 4.8 Jul	5.4 Aug	5.0
Netherlands	+ 0.5	nil Q2	+ 0.6	+ 1.8	– 3.0 Jun	+ 3.2 Jul	2.3 Aug**	2.0
Spain	+ 1.8	+ 2.0 Q2	+ 1.9	+ 2.6	+ 1.8 Jul	na	11.3 Aug	10.6
Sweden	+ 2.4	+ 2.1 Q2	+ 1.8	+ 2.6	– 1.3 Jun	+ 4.7 Jul	4.1 Aug†	4.3
Switzerland	+ 0.4	– 0.4 Q2	+ 0.3	+ 1.6	– 2.0 Q2	+ 1.7 Jul	2.7 Aug†	1.7
United States	+ 1.3	+ 2.2 Q2	+ 2.4	+ 2.8	+ 0.4 Aug	+ 6.1 Aug	5.7 Aug	4.9
Euro area	+ 1.4	+ 0.6 Q2	+ 0.8	+ 2.0	– 0.5 Jul	+ 1.4 Jul	8.3 Aug	8.0
MORE COUNTRIES	Data for the countries below are not provided in printed editions of *The Economist*							
Finland	+ 8.8	+ 2.5 Q2	na	na	+ 1.4 Aug	+ 3.8 Jun	8.1 Aug†	7.8
Greece	na	+ 4.0 Q2	na	na	+ 1.9 Jul	na	na	na
Iceland	na	+ 3.12001	na	na	+ 3.3 2001	na	2.2 Aug†	1.1
Ireland	na	+ 2.9 Q1	na	na	+10.7 Jul	+ 1.4 Jul	4.4 Aug	3.7
Luxembourg	na	+ 3.52001	na	na	+ 4.3 May	– 9.1 Apr	2.8 Jul†	2.4
New Zealand	+ 7.1	+ 4.0 Q2	na	na	+ 4.3 Q1	+ 8.3 Q2	5.1 Q2	5.3
Norway	+ 3.1	+ 1.7 Q2	na	na	+ 4.5 Jul	+ 1.7 Aug	3.8 Q2	3.6
Portugal	+ 1.4	+ 1.4 Q1	na	na	– 2.0 Jul	+ 0.9 Jul	4.5 Q2†	3.9

*% change at an annual rate. †Not seasonally adjusted. ‡May-July; claimant count rate 3.1% in Aug. §EU harmonised rate 8.3% in Aug. **Jun-Aug. ††Revised series.

Text refers only to the first 16 countries listed

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Prices and wages

Oct 3rd 2002
From The Economist print edition

% change on year ago

	Consumer prices			The Economist poll consumer prices forecast		Producer prices			Wages/earnings		
	latest		year ago	2002	2003	latest		year ago	latest		year ago
Australia	+ 2.8	Q2	+ 6.0	+ 2.8	+ 2.5	– 1.1	Q2	+ 5.6	+ 3.7	Q2	+ 4.4
Austria	+ 1.9	Aug	+ 2.5	+ 1.7	+ 1.7	– 0.6	Aug	+ 1.7	+ 2.3	Aug	+ 2.9
Belgium	+ 1.3	Sep	+ 2.3	+ 1.6	+ 1.5	+ 0.8	Aug	– 1.0	+ 2.6	Q2	+ 2.6
Britain	+ 1.4	Aug	+ 2.1	+ 1.9	+ 2.4	+ 0.3	Aug	+ 0.2	+ 4.0	Jul	+ 4.6
Canada	+ 2.6	Aug	+ 2.8	+ 2.0	+ 2.5	+ 0.4	Aug	+ 0.8	+ 3.0	Jul	+ 1.6
Denmark	+ 2.3	Aug	+ 2.5	+ 2.3	+ 2.0	– 0.3	Aug	+ 1.5	+ 3.7	Q2	+ 4.7
France	+ 1.8	Aug	+ 1.9	+ 1.8	+ 1.4	– 0.2	Aug	+ 0.9	+ 3.8	Q2	+ 4.2
Germany	+ 1.1	Sep	+ 2.1	+ 1.4	+ 1.1	– 0.5	Aug	+ 1.5	+ 2.1	Jul	+ 1.7
Italy	+ 2.6	Sep	+ 2.6	+ 2.4	+ 1.9	+ 0.2	Aug	+ 1.2	+ 2.5	Aug	+ 2.5
Japan	– 0.9	Aug	– 0.7	– 0.9	– 0.6	– 1.3	Aug	nil	– 3.4	Aug	– 1.3
Netherlands	+ 3.3	Aug	+ 4.7	+ 3.7	+ 2.4	+ 0.2	Aug	+ 1.8	+ 3.1	Aug	+ 5.0
Spain	+ 3.6	Aug	+ 3.7	+ 3.3	+ 2.6	+ 0.8	Aug	+ 1.6	+ 4.0	Q1	+ 3.4
Sweden	+ 2.0	Aug	+ 3.1	+ 2.3	+ 2.0	– 0.3	Aug	+ 1.5	+ 2.3	Jul	+ 2.6
Switzerland	+ 0.5	Sep	+ 0.7	+ 0.7	+ 1.0	– 1.4	Aug	– 0.2	+ 2.5	2001	+ 1.3
United States	+ 1.8	Aug	+ 2.7	+ 1.6	+ 2.2	– 1.6	Aug	+ 2.0	+ 3.1	Aug	+ 4.1
Euro area	+ 2.2	Sep	+ 2.2	+ 2.2	+ 1.6	– 0.2	Aug	+ 1.7	+ 3.3	Q1	+ 2.8
MORE COUNTRIES	Data for the countries below are not provided in printed editions of *The Economist*										
Finland	+ 1.4	Aug	+ 2.6	na	na	– 1.8	Aug	– 0.1	+ 3.8	Q2	+ 4.9
Greece	+ 3.5	Aug	+ 3.8	na	na	+ 0.7	Jul	+ 4.5	na		na
Iceland	+ 3.1	Sep	+ 8.4	na	na	+ 6.1	Sep	+ 6.8	+ 6.0	Aug	+ 8.8
Ireland	+ 4.5	Aug	+ 4.6	na	na	– 0.8	Aug	+ 1.0	+ 8.9	Q1	+ 7.4
Luxembourg	+ 1.8	Aug	+ 2.8	na	na	– 1.0	Jul	+ 0.6	+ 0.9	May	+ 2.7
New Zealand	+ 2.8	Q2	+ 3.2	na	na	+ 1.5	Q2	+ 8.1	+ 2.1	Q2	+ 1.8
Norway	+ 1.4	Aug	+ 2.7	na	na	– 8.6	Aug	– 4.3	+ 4.9	Q2	+ 4.4
Portugal	+ 3.7	Aug	+ 4.0	na	na	– 1.8	Aug	– 0.2	– 0.2	Jun	– 0.6

Text refers only to the first 16 countries listed

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Economic forecasts

Oct 3rd 2002
From The Economist print edition

The Economist poll of forecasters, October averages (previous month's, if changed)

	Real GDP, % change				Consumer prices % increase		Current account % of GDP	
	Low/high range		average					
	2002	2003	2002	2003	2002	2003	2002	2003
Australia	3.4/4.6	3.0/4.3	3.8 (4.0)	3.5 (3.7)	2.8	2.5	-3.7	-3.8
Austria	0.3/1.1	1.2/2.5	0.7 (0.9)	1.9 (2.4)	1.7	1.7	-1.6(-2.2)	-1.7 (-1.9)
Belgium	0.3/1.2	1.5/2.7	0.6 (1.1)	2.0 (2.7)	1.6 (1.7)	1.5	5.0	5.1
Britain	1.3/2.0	2.0/3.3	1.6 (1.7)	2.7 (2.9)	1.9	2.4	-2.1	-2.0 (-1.9)
Canada	2.8/3.6	2.6/4.1	3.3	3.3 (3.4)	2.0 (1.8)	2.5 (2.2)	2.0 (2.1)	2.2
Denmark	1.3/2.0	1.5/2.5	1.7 (1.6)	2.1 (2.3)	2.3	2.0	2.2 (1.9)	2.0 (1.8)
France	0.9/1.8	1.3/3.1	1.1 (1.3)	2.2 (2.6)	1.8	1.4	1.7	1.6
Germany	0.1/0.7	0.6/2.3	0.4 (0.6)	1.6 (2.2)	1.4	1.1 (1.2)	1.4 (1.2)	1.1 (1.0)
Italy	0.3/1.0	1.1/2.8	0.5 (0.8)	1.9 (2.4)	2.4 (2.3)	1.9 (1.8)	nil(-0.1)	-0.1 nil
Japan	-1.2/1.5	-0.4/3.0	-0.7 (-0.5)	1.0	-0.9	-0.6 (-0.5)	2.8 (2.9)	2.8 (2.9)
Netherlands	0.1/1.5	0.9/2.5	0.6 (0.9)	1.8 (2.4)	3.7 (3.6)	2.4	3.5 (3.9)	3.6 (4.0)
Spain	1.6/2.3	2.0/3.5	1.9 (2.0)	2.6 (2.9)	3.3	2.6	-1.9(-2.1)	-1.6 (-1.8)
Sweden	1.5/2.0	1.9/3.0	1.8	2.6 (2.7)	2.3	2.0	3.3 (3.2)	3.4 (3.2)
Switzerland	-0.3/1.2	0.8/2.3	0.3 (0.9)	1.6 (2.2)	0.7 (1.0)	1.0 (1.2)	10.1(10.0)	10.3 (10.2)
United States	2.3/2.6	2.1/3.4	2.4 (2.5)	2.8 (3.0)	1.6	2.2	-4.7(-4.5)	-4.9 (-4.1)
Euro area	0.6/1.3	1.2/2.5	0.8 (1.0)	2.0 (2.4)	2.2 (2.1)	1.6	0.5	0.6 (0.5)

Sources: ABN Amro, Deutsche Bank, Economist Intelligence Unit, Goldman Sachs, HSBC Securities, KBC Bank, Merrill Lynch, J.P. Morgan Chase, Morgan Stanley, Nordea, Decision Economics, BNP Paribas, Royal Bank of Canada, Schroder Salomon Smith Barney, Scotiabank, Shinsei Bank, UBS Warburg

Each month *The Economist* surveys a group of forecasters and calculates the average of their predictions for economic growth, inflation and current-account balances for 15 countries and for the euro area. The table also shows the highest and lowest projections for growth. The previous month's forecasts, where different, are shown in brackets. The panel has become notably gloomier about the prospects for recovery. It has downgraded forecasts of GDP growth for 12 countries in 2002 and 14 in 2003. The outlook for the euro area has deteriorated sharply. GDP is now expected to increase by only 0.8% in 2002 and by 2.0% in 2003. Germany is forecast to grow by just 0.4% this year and by 1.6% in 2003. Although the panel has trimmed its forecasts for American GDP growth, the United States will still outstrip the euro area by a wide margin in both years.

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Money and interest rates

Oct 3rd 2002
From The Economist print edition

	Money supply* % change on year ago			Interest rates % p.a. (Oct 2nd 2002)					
				3-mth money market		2-year	10-year gov't bonds		corporate
	narrow	broad		latest	year ago	gov't bonds	latest	year ago	bonds
Australia	– 4.2	+ 8.8	Aug	4.92	4.40	4.88	5.46	5.42	6.68
Britain	+ 8.6	+ 5.8	Aug	3.88	4.44	3.54	4.45	4.76	5.76
Canada	+16.2	+ 7.3	Aug	2.77	2.99	3.31	4.96	5.25	6.84
Denmark	+ 6.3	+ 7.0	Aug	3.45	3.90	3.55	4.56	4.84	6.86
Japan	+31.5	+ 3.5	Aug	0.01	0.01	0.00	1.13	1.38	1.20
Sweden	+ 2.2	+ 4.2	Jun	4.01	3.65	4.19	4.86	5.10	4.80
Switzerland	+12.0	+ 5.8	Aug	0.75	2.22	1.15	2.57	3.15	3.78
United States	+ 3.2	+ 8.3	Aug	1.70	2.45	1.75	3.70	4.48	6.20
Euro area†	+ 7.8	+ 7.0	Aug	3.28	3.62	3.13	4.32	4.65	5.24

*Narrow: M1 except Britain and Sweden M0, broad: M2 or M3 except Britain M4. † Germany for bonds. Benchmarks: US 30-year 4.72%, Japan No.242 1.14%. Central bank rates: US fed funds 1.75%, ECB refinancing 3.25%, BOJ overnight call 0.002%, BOE repo 4.00%. Sources: Commerzbank, Danske Bank, J.P. Morgan Chase, Royal Bank of Canada, Stockholmsbörsen, UBS Warburg, DRI-WEFA, Westpac, Thomson Datastream. Rates cannot be construed as banks' offers.

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The Economist commodity price index

Oct 3rd 2002
From The Economist print edition

1995=100

	Sep 24th	Oct 1st*	% change on one month	% change on one year
Dollar index				
All items	74.8	74.3	+ 0.7	+16.7
Food	80.4	79.5	+ 1.5	+21.2
Industrials				
All	67.2	67.4	– 0.5	+10.1
Nfa†	70.3	70.7	+ 0.3	+20.6
Metals	64.5	64.5	– 1.2	+ 1.8
Sterling index				
All items	75.8	74.7	+ 0.4	+ 9.0
Euro index				
All items	100.3	99.3	+ 2.0	+ 8.6
Yen index				
All items	98.2	97.0	+ 5.4	+18.4
Gold				
$ per oz	326.80	321.40	+ 2.4	+10.6
West Texas Intermediate				
$ per barrel	30.84	30.77	+10.8	+38.0

* Provisional. † Non-food agriculturals.

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Stockmarkets

Oct 3rd 2002
From The Economist print edition

Market indices

	Oct 2nd	2002 high	2002 low	% change on one week	% change on record high	% change on Dec 31st 2001 in local currency	% change on Dec 31st 2001 in $ terms
Australia (All Ordinaries)	2,951.8	3,440.0	2,928.3	+ 0.2	-14.2	-12.1	- 6.6
Austria (ATX)	1,078.0	1,357.2	1,049.2	+ 1.5	-37.9	- 5.5	+ 4.5
Belgium (Bel 20)	1,949.9	2,899.8	1,837.5	+ 3.2	-47.0	-29.9	-22.5
Britain (FTSE 100)	3,905.2	5,323.8	3,671.1	+ 5.7	-43.6	-25.2	-19.5
Canada (Toronto Composite)	6,100.7	7,958.1	6,068.9	- 1.0	-46.4	-20.7	-20.0
Denmark (KBX)	162.4	233.4	158.3	- 0.2	-46.2	-27.8	-20.1
France (SBF 250)	1,964.5	3,081.9	1,867.0	+ 4.1	-55.3	-34.1	-27.1
(CAC 40)	2,940.8	4,688.0	2,742.8	+ 5.6	-57.5	-36.4	-29.7
Germany (Xetra DAX)	2,926.7	5,462.6	2,769.0	- 1.2	-63.7	-43.3	-37.3
Italy (BCI)	1,026.5	1,513.0	1,004.3	nil	-53.0	-28.4	-20.8
Japan (Nikkei 225)	9,049.3	11,979.9	9,049.3	- 1.3	-76.7	-14.2	- 8.6
(Topix)	893.2	1,139.4	886.4	- 0.8	-69.0	-13.5	- 7.9
Netherlands (AEX)	317.4	531.2	293.8	+ 5.8	-54.8	-37.4	-30.7
Spain (Madrid SE)	593.4	848.1	570.5	+ 2.8	-48.2	-28.0	-20.4
Sweden (Affarsvarlden Gen)	133.9	236.8	130.3	+ 0.1	-66.6	-42.2	-34.1
Switzerland (Swiss Market)	4,848.7	6,694.1	4,561.4	+ 4.4	-42.4	-24.4	-15.4
United States (DJIA)	7,755.6	10,635.3	7,591.9	- 1.1	-33.8	-22.6	-22.6
(S&P 500)	827.9	1,172.5	797.7	- 1.4	-45.8	-27.9	-27.9
(Nasdaq Comp)	1,187.3	2,059.4	1,172.1	- 2.9	-76.5	-39.1	-39.1
Europe (FTSE Eurotop 300)*	856.9	1,279.7	808.6	+ 4.4	-49.7	-32.0	-24.9
Euro area (FTSE Ebloc 100)*	699.3	1,125.1	657.1	+ 4.3	-54.9	-37.1	-30.5
World (MSCI)†	750.2	1,024.4	734.8	+ 0.4	-48.2	na	-25.2
World bond market (Salomon)‡	497.9	504.2	430.3	+ 0.3	- 1.2	na	+13.3

*In euro terms. †Morgan Stanley Capital International index includes individual markets listed above plus eight others, in dollar terms.
‡Salomon Smith Barney World Government Bond Index, total return, in $ terms.

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Trade, exchange rates and budgets

Oct 3rd 2002
From The Economist print edition

	Trade balance*, $bn latest 12 months		Current account $bn latest 12 mths		The Economist poll % of GDP, forecast 2002	2003	Exchange rate trade-weighted† Oct 2nd	year ago	Currency units per $ Oct 2nd	year ago	per £	per euro	per ¥100	Budget balance % of GDP 2002‡
Australia	– 1.7	Aug	– 11.6	Q2	– 3.7	– 3.8	73.1	68.7	1.84	2.01	2.88	1.81	1.49	0.1
Austria	– 1.4	Jun	– 0.9	Jul	– 1.6	– 1.7	na	100.4	1.02	1.09	1.59	–	0.82	-0.3
Belgium	+ 14.7	Jul	+ 11.8	Mar§	+ 5.0	+ 5.1	na	99.4	1.02	1.09	1.59	–	0.82	nil
Britain	– 44.9	Jul	– 25.8	Q2	– 2.1	– 2.0	106.9	106.4	0.64	0.68	–	0.63	0.52	-0.8
Canada	+ 34.3	Jul	+ 12.1	Q2	+ 2.0	+ 2.2	75.1	76.4	1.58	1.57	2.48	1.56	1.29	1.0
Denmark	+ 7.1	Jul	+ 3.3	Jul	+ 2.2	+ 2.0	102.9	103.3	7.54	8.08	11.8	7.43	6.13	2.2
France	+ 10.2	Jul	+ 27.3	Jul	+ 1.7	+ 1.6	na	102.0	1.02	1.09	1.59	–	0.82	-2.0
Germany	+104.5	Jul	+ 30.2	Jul	+ 1.4	+ 1.1	na	99.1	1.02	1.09	1.59	–	0.82	-2.8
Italy	+ 9.8	Jun	– 3.2	Jun	nil	– 0.1	na	72.8	1.02	1.09	1.59	–	0.82	-1.4
Japan	+ 83.8	Jul	+110.9	Jul	+ 2.8	+ 2.8	131.3	138.2	123	121	193	121	–	-8.0
Netherlands	+ 25.0	Jul	+ 2.7	Q2	+ 3.5	+ 3.6	na	98.4	1.02	1.09	1.59	–	0.82	0.1
Spain	– 36.7	Jul	– 15.3	Jun	– 1.9	– 1.6	na	74.5	1.02	1.09	1.59	–	0.82	-0.3
Sweden	+ 14.6	Aug	+ 8.1	Jul	+ 3.3	+ 3.4	78.1	71.8	9.21	10.6	14.4	9.07	7.48	2.1
Switzerland	+ 3.5	Aug	+ 22.7	Q2	+10.1	+10.3	114.8	111.9	1.48	1.61	2.32	1.46	1.20	na
United States	–438.5	Jul	–428.8	Q2	– 4.7	– 4.9	114.6	117.3	–	–	1.57	0.98	0.81	-1.0
Euro area	+ 83.3	Jul	+ 27.5	Jul	+ 0.5	+ 0.6	81.8	79.8	1.02	1.09	1.59	–	0.82	-1.5
MORE COUNTRIES	Data for the countries below are not provided in printed editions of *The Economist*													
Finland	+ 12.7	Jul	+ 8.7	Jul	na	na	na	79.2	1.02	1.09	1.60	–	0.83	3.2
Greece	– 19.4	Jun	– 7.8	Jul	na	na	na	57.6	1.02	1.09	1.60	–	0.83	0.4
Iceland	+ 0.2	Aug	– 0.1	Q2	na	na	na	na	88.3	100.9	138	86.9	71.7	-0.5
Ireland	+ 34.0	Jul	– 0.4	Q1	na	na	na	88.0	1.02	1.09	1.60	–	0.83	0.1
Luxembourg	– 2.7	Jun	+ 1.7	Q1	na	na	na	99.4	1.02	1.09	1.60	–	0.83	2.2
New Zealand	– 0.1	Aug	– 1.3	Q2	na	na	87.4	77.4	2.13	2.45	3.34	2.10	1.73	0.1
Norway	+ 24.5	Aug	+ 25.5	Jul	na	na	106.2	96.1	7.51	8.78	11.8	7.39	6.10	14.0
Portugal	– 12.6	Jun	– 9.5	Jun	na	na	na	89.7	1.02	1.09	1.60	–	0.83	-2.4

*Merchandise. Australia, Britain, France, Canada, Japan and United States imports fob, exports fob. All others cif/fob. †1990=100, Bank of England. ‡OECD forecast. §New series.

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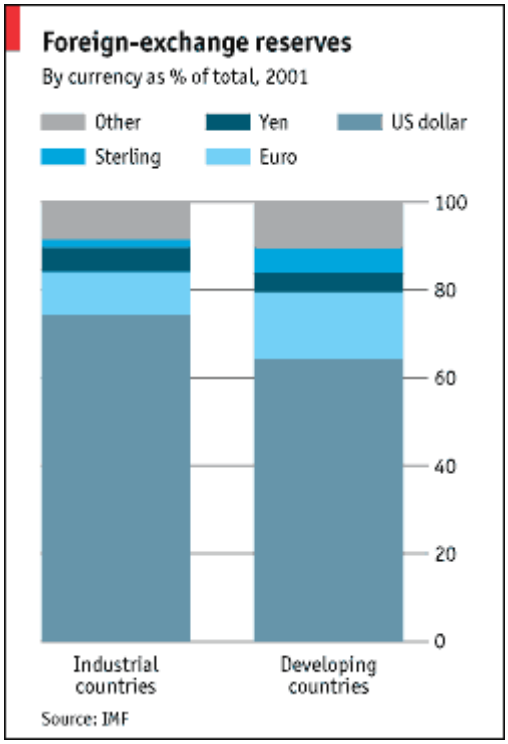
Foreign-exchange reserves

Oct 3rd 2002
From The Economist print edition



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Overview

Oct 3rd 2002
From The Economist print edition

Argentina's trade surplus rose to $14.1 billion in the year to August. But this was driven by collapsing imports, which fell by a huge 58% from their level of a year ago, rather than by rising exports. Exports actually fell by 15% over the same period.

Brazil's trade surplus is also breaking records. In the year to September, the trade surplus reached $9.2 billion, compared with a deficit of $0.2 billion a year earlier.

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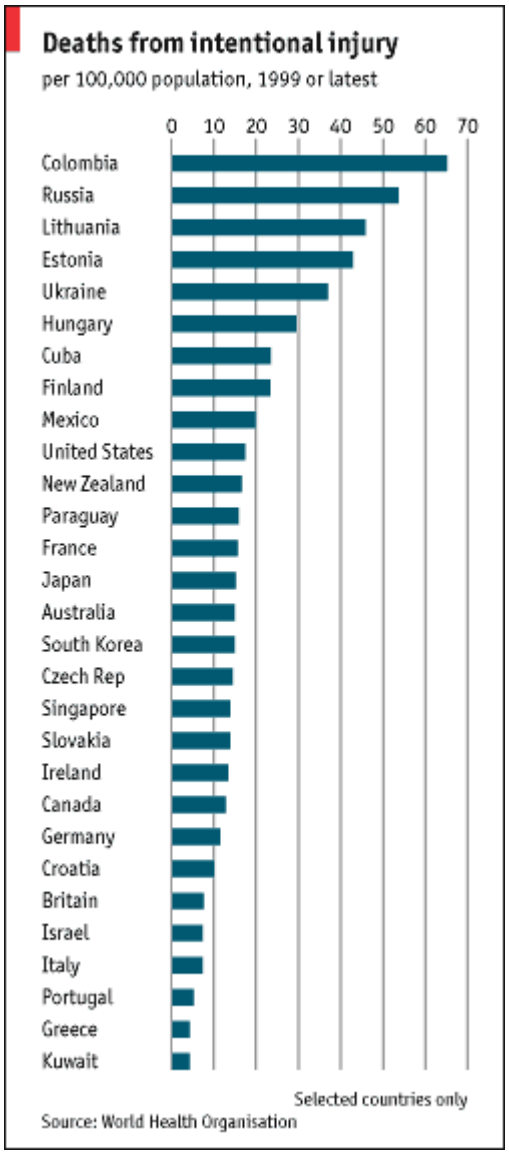
Deaths from intentional injury

Oct 3rd 2002
From The Economist print edition

More than 1.6m people die each year from homicide, suicide, war and other “intentional injuries”, according to a new report on violence and health from the World Health Organisation (WHO). Among the hardest-hit places are the countries of Eastern Europe, notably Russia. Death rates from violence in poor countries are more than double the level in rich ones. The cost is measured in money as well as lives: Colombia, for example, spends 5% of its GDP on health care for victims, many of whom have been injured in the country's civil war. The WHO recommends better education and firearms control to stem violent deaths worldwide.



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Economy

Oct 3rd 2002
From The Economist print edition

	% change on year ago						Latest 12 months, $bn				Foreign reserves* $bn, latest	
	GDP		Industrial production		Consumer prices		Trade balance		Current account			
China	+ 8.0	Q2	+12.7	Aug	– 0.7	Aug	+29.1	Aug	+17.4	2001	246.8	Jun
Hong Kong	+ 0.5	Q2	–11.2	Q2	– 3.3	Aug	– 8.4	Aug	+15.7	Q2	112.3	Aug
India	+ 6.0	Q2	+ 6.4	Jul	+ 3.9	Aug	– 5.1	Aug	+ 2.0	Q2	58.3	Aug
Indonesia	+ 3.5	Q2	–13.8	Q1	+10.1	Sep	+26.6	Aug	+ 6.1	Q1	29.3	Aug
Malaysia	+ 3.8	Q2	+ 6.9	Jul	+ 2.1	Aug	+12.8	Aug	+ 6.9	Q2	33.0	Aug
Philippines	+ 4.5	Q2	+ 6.4	Jul	+ 2.9	Aug	+ 2.8	Jul	+ 6.3	Jun	13.4	Aug
Singapore	+ 3.9	Q2	+15.8	Aug	– 0.4	Aug	+ 6.9	Aug	+17.5	Q2	80.9	Aug
South Korea	+ 6.3	Q2	+ 8.5	Aug	+ 3.1	Sep	+ 9.9	Sep	+ 5.5	Aug	116.5	Aug
Taiwan	+ 3.0	Q2	+ 5.8	Aug	– 0.3	Aug	+18.6	Aug	+24.8	Q2	156.4	Aug
Thailand	+ 5.1	Q2	+11.4	Aug	+ 0.4	Sep	+ 3.4	Aug	+ 6.3	Aug	37.7	Aug
Argentina	–13.6	Q2	– 9.2	Aug	+36.5	Aug	+14.1	Aug	+ 3.9	Q2	9.2	Aug
Brazil	+ 1.0	Q2	+ 3.3	Jul	+ 7.5	Aug	+ 9.2	Sep	–15.2	Aug	37.6	Aug
Chile	+ 1.7	Q2	– 1.0	Aug	+ 2.2	Aug	+ 2.4	Aug	– 0.6	Q2	15.0	Jul
Colombia	+ 2.2	Q2	– 1.2	Jun	+ 6.0	Aug	+ 0.5	Jul	– 1.4	Q1	10.6	Aug
Mexico	+ 2.1	Q2	+ 1.9	Jul	+ 5.3	Aug	– 9.0	Aug	–16.3	Q2	46.1	Jul
Peru	+ 3.8	Jul	+ 6.8	Jul	+ 0.7	Sep	+ 0.2	Jul	– 1.0	Q2	9.5	Aug
Venezuela	– 9.9	Q2	–17.1	Jun	+28.2	Sep	+ 8.5	Q2	+ 1.9	Q2	7.6	Jun
Egypt	+ 4.9	2001†	+ 7.8	2001†	+ 2.6	Jul	– 7.9	Jun	nil	Q2	12.6	May
Israel	– 1.7	Q2	– 1.8	Jul	+ 6.2	Aug	– 6.1	Aug	– 2.3	Q1	24.5	Aug
South Africa	+ 2.2	Q2	+ 7.8	Jul	+11.6	Aug	+ 3.4	Aug	– 0.3	Q2	6.0	Aug
Turkey	+ 8.2	Q2	+12.3	Jul	+40.2	Aug	–10.9	Jul	+ 1.5	Jul	25.1	Aug
Czech Republic	+ 2.5	Q2	+10.8	Jul	+ 0.6	Aug	– 2.3	Aug	– 2.3	Q2	21.6	Aug
Hungary	+ 3.1	Q2	+ 5.1	Jul	+ 4.5	Aug	– 2.6	Aug	– 2.4	Aug	10.3	Aug
Poland	+ 0.8	Q2	– 1.1	Aug	+ 1.2	Aug	–10.3	Aug	– 6.4	Aug	28.3	Aug
Russia	+ 4.1	Q2	+ 3.4	Aug	+15.2	Aug	+42.4	Jul	+28.3	Q2	40.6	Aug
MORE COUNTRIES	Data for the countries below are not provided in printed editions of *The Economist*											
Pakistan	+ 3.3	2001†	+ 2.8	May	+ 3.7	Aug	– 1.1	Aug	+ 2.7	2002†	4.8	Jun
Saudi Arabia	+ 1.2	2001	na		– 0.2	Apr	+44.1	2001	+14.5	2001	18.1	Jul

*Excluding gold, except Singapore; IMF definition. †Year ending June.

Text refers only to the first 25 countries listed

Sources: National statistics offices, central banks and stock exchanges; Thomson Financial Datastream; Economist Intelligence Unit; Reuters; Warburg Dillon Read; J.P Morgan Chase; Hong Kong Monetary Authority; Centre for Monitoring Indian Economy; FIEL; EFG-Hermes; Bank Leumi Le-Israel; Standard Bank Group; Garanti Bank; Deutsche Bank; *Russian Economic Trends*.

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Financial markets

Oct 3rd 2002
From The Economist print edition

	Currency units			Interest rates	Stockmarkets	% change on		
	per $		per £	short-term	Oct 2nd		Dec 31st 2001	
	Oct 2nd	year ago	Oct 2nd	% p.a.		one week	in local currency	in $ terms
China	8.28	8.28	13.0	na	1,650.5	-1.0	- 3.6	- 3.6
Hong Kong	7.80	7.80	12.2	1.87	9,109.4	-0.2	- 20.1	- 20.1
India	48.3	47.9	75.7	5.76	2,959.7	-2.0	- 9.3	- 9.5
Indonesia	9,007	9,905	14,103	14.15	409.5	+0.2	+ 4.5	+ 20.6
Malaysia	3.80	3.80	5.95	3.20	646.5	+1.5	- 7.1	- 7.1
Philippines	52.7	51.6	82.5	6.88	1,114.7	-1.1	- 4.6	- 6.5
Singapore	1.79	1.78	2.80	1.38	1,355.4	+1.0	- 16.5	- 13.8
South Korea	1,225	1,304	1,919	4.86	648.1	-1.5	- 6.6	+ 0.1
Taiwan	34.9	34.6	54.7	2.10	4,171.8	-0.3	- 24.8	- 24.7
Thailand	43.5	44.7	68.1	2.00	335.4	-0.2	+ 10.4	+ 12.3
Argentina	3.75	1.00	5.86	26.70	392.1	+3.1	+ 32.7	- 64.6
Brazil	3.60	2.73	5.63	17.90	8,819.5	-4.5	- 35.0	- 58.3
Chile	742	698	1,161	2.64	4,697.1	-0.7	- 13.0	- 22.4
Colombia	2,890	2,337	4,524	7.93	1,255.9	+1.5	+ 17.3	- 7.6
Mexico	10.13	9.52	15.9	8.60	5,827.7	+0.3	- 8.5	- 17.2
Peru	3.62	3.48	5.68	7.58	1,154.8	+0.4	- 1.8	- 6.7
Venezuela	1,472	743	2,304	29.11	7,487.9	+1.6	+ 14.0	- 41.3
Egypt	4.65	4.26	7.27	6.97	5,271.5	-0.1	nil	- 1.5
Israel	4.83	4.37	7.57	6.40	335.6	-1.1	- 24.9	- 31.4
South Africa	10.4	9.32	16.3	13.50	9,530.8	+1.2	- 8.7	+ 5.0
Turkey	1,642,500	1,587,000	2,571,827	42.00	9,001.2	-1.3	- 34.7	- 42.1
Czech Republic	30.8	36.5	48.3	2.87	440.9	-1.6	+ 11.7	+ 28.8
Hungary	247	280	387	9.65	6,951.4	-5.0	- 2.5	+ 8.3
Poland	4.15	4.18	6.49	7.68	12,771.2	-2.3	- 8.3	- 12.6
Russia	31.7	29.5	49.6	21.00	341.4‡	-0.5	+ 36.5	+ 31.3
EMF (MSCI)*	1.00	1.00	1.57	na	269.6	nil	na	- 15.0
EMBI+†	1.00	1.00	1.57	na	203.9	+0.7	na	+ 1.8

*Emerging Mkts Free. †J.P. Morgan Chase's Emerging Mkts Bond Index Plus. ‡ In $ terms.
Sources: National statistics offices, central banks and stock exchanges; Thomson Financial Datastream; Economist Intelligence Unit; Reuters; Warburg Dillon Read; J.P Morgan Chase; Hong Kong Monetary Authority; Centre for Monitoring Indian Economy; FIEL; EFG-Hermes; Bank Leumi Le-Israel; Standard Bank Group; Garanti Bank; Deutsche Bank; *Russian Economic Trends*.

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